

**FLORIDA DEPARTMENT OF TRANSPORTATION
REIMBURSEMENT RATE AUDIT GUIDELINES**



**OFFICE OF
INSPECTOR GENERAL**

2005

FLORIDA DEPARTMENT OF TRANSPORTATION REIMBURSEMENT RATE AUDIT GUIDELINES

OVERVIEW

The reimbursement rate audit guidelines are divided into three separate sections:

SECTION 1. FDOT POLICIES AND REQUIREMENTS

Explains what is required of administratively qualified consultants and new consultants seeking qualification. This section gives details on the contents of CPA prepared Reimbursement Rate Audit Reports and the Department's accounting and auditing requirements.

SECTION 2. FLORIDA STATUTE 112.061

Per diem and travel expenses of public officers, employees, and authorized persons, are limited by the provisions of F.S. 112.061. The statute applies to overhead and direct expense travel costs.

SECTION 3 UNIFORM AUDIT & ACCOUNTING GUIDE, September 2005

The American Association of State Highway and Transportation Officials (AASHTO) Audit Subcommittee developed this guide with assistance from the American Council of Engineering Companies (ACEC) Transportation Committee and the Southern Resource Center of The Federal Highway Administration (FHWA). The purpose of the guide is to provide a tool that can be used by individual state auditors, consulting firms and public accounting firms that perform audits of consulting firms. The primary focus of the guide is auditing and reporting on the indirect costs and resultant overhead rates of consultants who perform engineering and other professional services for state highway agencies. Annotations and clarifications setting forth FDOT interpretations have been added to the guide for some sections.

Due to constant revision of the Federal Acquisition Regulations (FAR), Subpart 31- Contract Cost Principles and Procedures is not included with the guidelines. The FARs may be obtained from the Internet at: <http://www.arnet.gov/far>.

The US Treasury Prompt Payment Act Interest Rates (formerly Renegotiations Board Interest Rate) for the calculations of the facilities capital cost of money rate are also available on the Internet at:
<http://www.publicdebt.treas.gov/opd/opdprmt2.htm>

These *Guidelines* and other references and policies may be accessed from the Procurement Office home page: <http://www.dot.state.fl.us/procurement>

Reimbursement Rate Audit Guidelines, 2005, Section 1
Florida Department of Transportation



Florida Department of Transportation

JEB BUSH
GOVERNOR

605 Suwannee Street
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DENVER J. STUTLER, JR.
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Foreword

Chapter 14-75, Florida Administrative Code, requires professional consultants to have an adequate accounting system and to submit an annual rate audit as a prerequisite to qualify to perform work for the Florida Department of Transportation. The information contained in the following pages was developed to provide guidance to consultants and to the auditors who will be conducting the audits. The Department's Office of Inspector General, External Audit Section, prepared these guidelines.

Questions related to these guidelines should be directed to David D. Beals, Office of Inspector General at (850) 410-5834. Copies of this document are available from the Office of Inspector General or the Department's Procurement Office. The Guidelines are also available on the Internet at <http://dot.state.fl.us/procurement/pubs/pubsmenu.htm>.

Cecil T. Bragg, Jr., C.P.A.
Inspector General

December 2005

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Section 1

FDOT Policies and Requirements

Part I – Introduction and Authority

The procurement or acquisition of professional architectural, engineering, landscape architectural, surveying, and other professional services by agencies of Florida state government must be carried out in accordance with the “Consultant’s Competitive Negotiation Act,” codified as Florida Statute 287.055. This broad statute, and several more specific, but consistent, statutes, establish the requirement that prospective providers of professional services must be “certified” as “qualified” prior to entry into a contract to provide services. Florida Statute 287.055 (3) (b) and (c) state and require:

“(b) Each agency shall encourage firms engaged in the lawful practice of their professions that desire to provide professional services to the agency to submit annually statements of qualifications and performance data.

(c) Any firm or individual desiring to provide professional services to the agency must first be certified by the agency as qualified pursuant to law and the regulations of the agency. The agency must find that the firm or individual to be employed is fully qualified to render the required service. Among the factors to be considered in making this finding are the capabilities, adequacy of personnel, past record, and experience of the firm or individual.”

The implementing regulation promulgated by the Florida Department of Transportation is set forth in Florida Administrative Code Chapter 14-75, as amended. Rule 14-75.0022, Consultant Qualification Process, requires annual submittal of a “Request for Qualification Package for Professional Consultants,” and in subsection (3) (c) provides:

“(c) The Request for Qualification Package for Professional Consultants will include the following items:

1. An audit report prepared by an independent Certified Public Accountant or governmental agency. The audit report must be received by the Department within six months of the end of the fiscal year it addresses and will include the following:
 - a. A statement indicating the existence of an adequate accounting system that meets the Department’s audit requirements, as evidenced by a certification by an independent Certified Public Accountant or governmental agency. The system must be adequate to support all billings made to the Department and other clients.

- b. A statement indicating the direct labor costs incurred, listing allocable indirect costs, and listing other direct costs incurred for the most recently completed fiscal year.
- c. A statement of reimbursement rates for indirect costs (overhead), direct expenses, and Facilities Capital Cost of Money (FCCM) for the most recently completed fiscal year.
- d. A statement that the consultant's method of estimating costs for proposals is consistent with the accounting system.
- e. A statement that the audit was performed in accordance with generally accepted governmental auditing standards, the Department's *Reimbursement Rate Audit Guidelines, 2005*, and the *Government Auditing Standards, 2003 Revision*, published by the U.S. Government Printing Office, which are hereby incorporated by reference."

The application must also include proof of professional liability insurance and a description of the firm's capabilities and staff, together with a request for pre-qualification to perform work in specific workgroups. The Rule also provides exceptions from the "audit report" requirement for newly organized, or newly reorganized, consultants and for consultant's seeking prequalification to perform appraisal services or to prepare or review business damage estimates under Work Groups 20 or 22, and those seeking prequalification for minor projects, with fees under \$250,000.

These *Guidelines* are intended to provide guidance in preparing audit reports for submission to the Florida Department of Transportation. The *Guidelines* take their authority from having been incorporated into the Department's administrative regulation, shown above in subparagraph e. Nonetheless, the *Reimbursement Rate Audit Guidelines, 2005*, are guidelines, not laws or rules. When the *Guidelines* are intended to help consultants and CPAs comply with requirements which are based in laws or rules, we have attempted to indicate the source of the requirement.

In addition to certification of the adequacy of the accounting system, the purpose for the audit report requirement in the Request for Qualification Package is to facilitate the establishment and acceptance of reimbursement rates to be applied in contracting with the consultant in the upcoming year. The Department accepts three separate reimbursement rates; an overhead rate for the reimbursement of indirect costs, a direct expenses rate for reimbursement of non-labor direct costs, and a facilities capital cost of money rate (FCCM) to reimburse the consultant for "opportunity costs" lost when investing in plant and facilities. There is no "cap" on audit-based reimbursement rates. The Department's adoption of the "direct expense rate" in particular, and to a lesser extent the acceptance of a separate FCCM rate, makes the audit reporting requirements for the Florida Department of Transportation, unique. These *Guidelines* are intended to increase awareness and understanding of both national standards and the Department's unique requirements.

Reimbursement Rates

All of the Department's reimbursement rates are based on the consultant's reported direct labor base, excluding premium overtime, for the audit year. It is the policy of the Florida Department of Transportation that there must exist a consistent direct labor base for calculation of overhead rates, direct expense rates, and FCCM rates. It is expected the direct labor base stated for the "Home Office" and, if applicable, the "Field Office" in the Statement of Direct Labor, Fringe Benefits, and General Overhead, or the Schedule of Indirect Costs, will be used as the base for calculating the direct expense rate and FCCM rate as well. Some audit reports propose reimbursement rates based on an allocation basis different from direct labor. The Department does not accept any rates using an alternative allocation base; the costs included within the supporting allocation pool are accepted, but these costs are allocated using the direct labor base. In an individual contract negotiation the reimbursement rates will be applied in relation to an amount of negotiated direct labor based on man-hours of effort and the average wage rate.

The Department reimburses a consultant's indirect costs of contract operations using an **overhead rate**, often referred to as a **combined overhead rate**. The "combined" rate is the total of the "Fringe Benefit" costs and the "General Overhead" costs in relation to the direct labor base. Fringe benefits are non-salary or wage costs associated with employees and employment taxes and are always treated as indirect costs by the Department. Reports which are prepared in accord with Cost Accounting Standards often report certain Fringe Benefit costs as direct expenses. The Department will calculate direct and indirect reimbursement rates consistent with the Consultant's reporting. General overhead includes all other indirect costs, including Indirect Labor. The Department's "Overhead rate" has the same meaning as "Overhead rate" in other states, Federal contracts, and the AASHTO Uniform Audit and Accounting Guide, reprinted in Section 3 of these *Guidelines*. For any of these sources the overhead rate envisions a measure for the reimbursement of indirect costs. Within any particular contract the Department makes no effort to reimburse the "actual" indirect costs; the historical rate from the most recent audit year is used to estimate the indirect costs to be incurred in the current year. Although some multi-year contracts do provide for in-term adjustment of the overhead rate to be applied, costs and reimbursements for indirect costs are not subject to subsequent adjustment based on the audit determination of the amount of "actual" indirect costs for the past period. There is an implicit assumption that the overhead rate will remain within an acceptable range from year to year.

The Department's policy on direct expense reimbursement makes essentially the same assumption for non-labor direct expenses. With the exception of extraordinary costs and the costs of subcontracted work which continue to be invoiced as incurred, the Department no longer reimburses the direct costs of professional services contracts based on invoiced actual costs. Nor does the Department commonly negotiate lump sum estimates of direct costs to be incurred under contracts. All professional services contracts negotiated since October 1, 2003 have included reimbursement of direct expenses by application of a **direct expenses rate** based on the audit listing of direct

costs in relation to the direct labor base. The direct costs incurred under a contract with the Department will be reimbursed as one of three component parts of total direct costs: negotiated direct labor, including employees and non-employees fulfilling the contractor's man-hour commitments; subcontracts and extraordinary items reimbursed on the basis of invoiced actual costs; or on the basis of the pre-established direct expense rate, paid as a consequence of the invoicing of direct labor as part of the contract multiplier. See the additional discussion of the direct expense rate disclosure in Section 1, Part IV C. 6. of these *Guidelines*.

The Federal Acquisition Regulations, 48 CFR 31.205-10, provides that the "cost of money" is allowable where "the estimated facilities capital cost of money is specifically identified and proposed in cost proposals relating to the contract under which the cost is to be claimed." (emphasis added). The Department has established a Facilities Capital Cost of Money (FCCM) reimbursement rate which requires no demonstration that the particular facilities will be used on any specific Department contract. The FCCM rate reimburses the cost of maintaining the facilities necessary to perform professional services for the Department, instead of investing the capital in other opportunities. There is a single FCCM rate for the firm as a whole, based on total direct labor (Home + Field). FCCM is determined from the "average net book value" of the consultant's capital assets and rates covering six month periods established and published by the U.S. Office of Management and Budget. FCCM rates are applied in Department contracts in the same manner as overhead and direct expense rates, based on negotiated, and invoiced, "direct labor" for the contract.

Part II – Accounting Systems and Procedures

To meet FDOT standards, an accounting system must separate and accumulate direct and indirect costs, and must be adequate to support billings to the Department and other clients (F.A.C. 14-75.0022 (3)(c)1.a.). The accounting system should include a suitable set of records (journals, ledgers), a reporting system, and the written policies and procedures used to process and record business transactions. Again, the capability to identify and separately report direct and indirect costs is the first and primary Departmental requirement for consultant accounting systems. A direct cost is typically any cost that can be identified to a single cost objective (job, contract, project). Any cost not directly identified to the production of a specific product or service, but an essential cost of doing business, is classified as an indirect cost.

The decision on whether certain costs should be recorded as direct or indirect depends largely on the consultant's normal and customary practices. Once this determination is made and documented in the written policies, the consultant's accounting procedures must be consistently followed in classifying, accumulating, and reporting costs.

Accounting system and basis of accounting disclosures and assurances are required in Reimbursement Rate Audit Reports submitted to FDOT. Please see the discussion of

the required elements of these disclosures and assurances in Section 1, Part IV C.1. and 2. of these *Guidelines*.

A. Job Cost Accounting Systems

In the vast majority of professional services contracts negotiated and awarded by the Department, the consultant is basically providing direct labor by the hour. When the consultant has the expectation of billing direct labor by the hour, the consultant **must** maintain and utilize a **job cost accounting system** to identify costs to specific contracts. The identification and accumulation of costs to specific contracts is necessary in order to “support all billings made to the Department and other clients” as required in F.A.C. Chapter 14-75.

An acceptable job cost accounting system must meet the following minimum requirements:

1. A general ledger in which direct and indirect costs are separated and accumulated.
2. A payroll system supported by time sheets that clearly identify project and account numbers charged (direct and indirect cost accounts).
3. Agreement between employee time sheets, hours recorded on labor distribution reports, and the hours and dollars summarized in the payroll records.
4. A job cost ledger or job cost report in which costs directly related to specific jobs or projects are recorded, with current period and project-to-date totals for labor hours and job costs.
5. A job cost ledger or job cost report which supports and agrees with the direct costs contained in the general ledger. Periodic reconciliation of job cost ledgers and the cost reports with the general ledger must be conducted.

B. Fee-for-Service Accounting System

Some consultants provide well defined services for a set price rather than billing hourly labor charges. For consultants who bill exclusively on a fee-for-service basis and maintain a published fee schedule, a formal job cost accounting system is not required. These consultants must still maintain an accounting system which segregates direct and indirect costs and can trace and support services provided to individual contracts, but they need not have the capability of reporting their costs to a particular contract. Fee-for-service consultants must demonstrate that they charge the Department the same unit rates per their fee schedule as they charge other clients for the same services.

Attempts to establish a “loaded labor rate,” even if the rate is specifically associated with a particular specialty, is not the same as establishing a fee for a “service.” “Services” are final products or completed processes which can be measured as deliverable units. Loaded labor rates are hourly labor rates which commonly include mark-ups for

overhead and profit which replace and substitute for the audit-based overhead, direct expense, FCCM rates, and the profit margin negotiated by the Department. Loaded labor rates are billed as labor by the hour and a job cost accounting system is required.

Consultants maintaining a published fee schedule and billing on the basis of fees for deliverable services are required to maintain an accounting system with the following essential elements:

1. Costs in the general ledger must be separated between direct and indirect costs.
2. Ability to track deliverable services by job in a subsidiary ledger on a unit rate (fee schedule) basis.
3. Use of time sheets and other documents supporting direct and indirect costs.
4. Records substantiating invoicing of deliverable units on a unit rate (fee schedule) basis.

C. Other (Mixed) Accounting Systems

Some consultants provide services which do not fit easily into either the “labor hour” or “fee-for-service” models. Certain consultants provide services for which the largest component of cost is equipment rather than labor and have proposed cost-based hourly rates for these services. When the costs associated with the services are so great that inclusion of the costs in the direct expense rate calculation would unreasonably skew the direct expense rate for contracts not utilizing the service, the Procurement Office and the Office of Inspector General will jointly approve use of a cost-based rate for the service. Other consultants may conduct the majority of their business using a published fee schedule on a fee-for-service basis but, nonetheless provide certain other services on a labor hour basis. **Consultants billing the Department for labor by the hour must maintain and operate a job cost accounting system.** However, the consultant’s accounting system, and the annual Reimbursement Rate Audit Report, must isolate and exclude from the reimbursement rate calculations the costs associated with fee schedule services or specialized services billed at the cost-based rates.

The costs of specialized services and fee schedule services contracted by and billed to the Department are paid as part of the rate or fee; these costs may not be included in the costs, particularly the direct costs, to be reimbursed to the same consultant for services provided on a labor by the hour basis. The indirect costs associated with an hour of direct labor is relatively the same whether the hour is devoted to a Department contract billed by the hour or devoted to subsurface utility exploration, a specialized service which may be paid under a cost-based rate. However, direct costs, including both direct labor and the direct costs includable in direct expenses listings, will vary widely by function or service performed. For example, the Department may contract for a series of aerial images on a fee schedule basis and a separate interpretation report to be billed by the hour. The costs of the airplane, pilot, photographer, and other costs incurred to produce the deliverable images are paid as part of the fee and should not be

included in the direct expense pool or the reimbursement rate applied to the hours invoiced for the consultant's photo interpreter.

These and similar circumstances have required acceptance of an exception to the Department's policy requiring a consistent direct labor base for use in calculating all reimbursement rates. Where a consultant reports cost-based rates for certain operations, or does not bill exclusively from a published fee schedule, the accounting system, and the annual report, must segregate and separately accumulate the direct costs of providing the cost-based or fee schedule operations. In calculating the audit-based direct expense rate, the direct labor attributable to these operations must be subtracted from the overall direct labor base and all direct costs attributable to the operations must be excluded from the qualified direct expenses for the cost center (Home or Field). The resultant rate will more accurately reflect the direct costs normally incurred in providing a contracted hour of direct labor. See Section 1, Part IV C. 2. c. and Part IV C. 6. of these *Guidelines* for a further discussion of the necessary disclosures and assurances and the reporting of direct expenses.

Part III – New Consultants / Provisional Rates

A. New Consultants

Consultants who have been in business for less than one complete year may submit their Request for Qualification Package for Professional Consultants with a projected overhead, direct expense, and FCCM rate, and a request for an Accounting System Review, in lieu of an independent audit report. The projected rates must be supported by an estimate of direct labor, fringe benefits, general overhead, and direct expense costs for the first, upcoming fiscal year of operation. The Department's Procurement Office will forward a request to the Office of Inspector General to initiate an Accounting System Review to determine the capability of the consultant's accounting system to meet the Department's audit requirements and to support potential billings made to the Department and other clients. Based on a determination of accounting system adequacy, the Office of Inspector General will review the cost estimates, make appropriate disallowances if necessary, and establish provisional reimbursement rates for use in the consultant's first year of operation (See discussion of Provisional Rates in Part III C., below). After the completion of the first fiscal year of operation, the consultant is required to submit a Reimbursement Rate Audit Report prepared by an independent Certified Public Accountant as part of the annual renewal Request for Qualification Package.

B. Accounting System Review Procedures

The following procedures are generally used by the Department's Office of Inspector General (OIG) to review the accounting system and projected reimbursement rates of a newly organized consultant when an independent audit report is not available.

Accounting System Reviews carried out by the OIG are intended to verify the consultant's accounting system meets the system requirements and Department expectations listed and discussed in Section 1, Part II A. of these *Guidelines*. Additional information concerning the standards, process, and performance of Accounting System Reviews is available as "Accounting System Info" on the Inspector General's website: <http://www.dot.state.fl.us/inspectorgeneral>.

1. Telephone Interview:

- a. The Consultant is contacted by telephone to obtain a preliminary understanding of the firm's accounting system.
- b. Inquiries are made about the consultant's timekeeping, payroll procedures and job cost accounting system.
- c. If the system appears to be adequate, a submission of documents is requested, otherwise a visit to the Consultant's office is scheduled.

2. Documents Needed for Submittal or Presentation at Field Visit

- a. Time Sheets
- b. Payroll Records
- c. Labor Distribution Reports
- d. Job Cost Ledger or Job Cost Report
- e. Summary of Job Cost Reports
- f. Chart of Accounts
- g. General Ledger

3. Approval of Accounting System

The Office of Inspector General (OIG) will review all documentation submitted or presented and may initiate such tests and system trials as may be deemed appropriate or necessary. The OIG will issue a memorandum to the consultant and the Procurement Office providing the overall results and determinations of the review. If the system is approved, the memorandum will include a statement the system is approved and will include the provisional reimbursement rates accepted for use in the first fiscal year of operation.

If the system is disapproved the memorandum will include an explanation of what needs to be done for the system to be approved.

C. Provisional Rates / Consultant Reorganization

In addition to provisional rates accepted upon completion of an Accounting System Review, when a consultant undergoes reorganization and determines that the

reimbursement rates supported by the pre-reorganization audit do not reasonably reflect the costs anticipated for the operating costs of the “new” organization, the consultant may request that provisional rates be established for use during the remainder of the fiscal year preceding the scheduled audit of the new organization. The request for provisional rates must include a declaration of the fiscal year end for which an independent auditor’s report will be prepared. The request for provisional rates must be supported by the most current financial information and forecasts available to the consultant. In the case of reorganization through merger or acquisition, the consultant must provide the first year projections utilized by the consultant in making the business decision to merge with or to acquire the business or assets of other entities involved in the reorganization. Supported requests for provisional rates will be forwarded by the Department’s Procurement Office to the Office of Inspector General. The Office of Inspector General will review the available financial information and establish appropriate provisional reimbursement rates for use in contracting with the consultant prior to receipt of the next annual Reimbursement Rate Audit Report.

Provisional rates established pursuant to the consultant’s request, whether established following an Accounting System Review or reorganization, may be applied for a period not to exceed eighteen months and are subject to maximum cap limitations set by the Department’s Procurement Office. Audit based reimbursement rates are not capped.

Part IV – Reimbursement Rate Audit Reports

The audit which forms the basis for Reimbursement Rate Audit Reports submitted to the Department in support of a consultant’s application for prequalification shall be performed by an independent Certified Public Accountant, an agency of the Federal government, another state transportation agency or similar independent audit organization. Reimbursement Rate Audit Reports consist of five component parts. The independent Certified Public Accountant is responsible for three components, two of which are often combined: The Independent Auditor’s Report, sometimes referred to as the Opinion letter, and the Auditor’s Reports on Compliance and Internal Controls, often combined into a single document. The Auditor’s Report must state the auditor’s Opinion on the parts of the Reimbursement Rate Audit Report that are the responsibility of management: a Statement of Direct Labor, Fringe Benefits and General Overhead, or similar schedule of indirect costs, and the accompanying Notes to the financial statement.

The Reimbursement Rate Audit Report must have as its subject organization the same legal entity seeking to be prequalified to contract with the Department. The report must provide information on the costs and operations of the contracting entity in order to establish reimbursement rates appropriate for the prospective contractor/consultant and because of privity of contract issues. Financial information for a parent corporation is not suitable to establish reimbursement rates for a subsidiary corporation. The audit information must apply to the corporate entity applying for prequalification.

A. Reports Prepared by the Independent Auditor

1. The Independent Auditor's Report

The Independent Auditor's Report is an almost "boilerplate" letter with minor variations from one audit firm to the next. However, the "clean Opinion" report is near boilerplate because the standard language contains a number of statements and assurances which are required for compliance with *Government Auditing Standards, 2003 Revision*. An Independent Auditor's Report and an auditor's Report on Compliance and Internal Controls, by a fictitious CPA firm for a fictitious client, which meet the applicable requirements are displayed on Pages 11 and 12 of 28, following. The principle change required in the 2003 Revision of the "Yellow Book," is an enhanced reference and attention to the associated Auditor's Reports on Compliance and Internal Controls in the Independent Auditor's Report. In addition, Chapter 9 of the AASHTO Uniform Audit & Accounting Guide, reprinted in Section 3 of these *Guidelines*, contains examples of acceptable reports, including an Opinion letter on page 9 – 2. The Independent Auditor's Report need not mirror the example reports but it must contain each of the following elements found in the example reports:

- a. Identifies the issuing agency or firm (letterhead);
- b. Audit performed as basis for Opinion;
- c. Audit performed in accord with *Government Auditing Standards*;
- d. Fiscal Year end within 18 months of application date;
- e. Basis of accounting practices statement cites FARs and may cite "other federal and state regulations;"
- f. An Opinion paragraph.
- g. Reference to the Reports of Compliance and Internal Controls.

2. Auditor's Reports on Compliance and Internal Controls

The Report on Compliance and the Report on Internal Control and Financial Reporting together with the Description of Accounting System Note (See Part IV C. 2., below) provide the auditor's evaluation of the adequacy of the consultant's accounting system. Although many CPA firms prefer to issue these reports separately, the combined reports shown on Page 12 and in Chapter 9 of the AASHTO Uniform Audit & Accounting Guide, reprinted in Section 3 of these *Guidelines*, page 9-4, are acceptable to the Department. When the Reports of Compliance and Internal Controls contain findings of reportable conditions, whether material or not, the Department prefers that the Management Response letter, stating management's position with regard to the finding, be

included with the Reimbursement Rate Audit Report. If reportable conditions are found and the Management Response letter is not included, the Department may request submission of management's statement of concurrence or objection before completing review of the Reimbursement Rate Audit Report.

Bragg, Owens, & Associates
Certified Public Accountants

Independent Auditor's Report on
Statement of Direct Labor, Fringe Benefits, and General Overhead

To the Board of Directors
Weir Engineers and Architects, Inc.
Sunshine State

We have audited the accompanying Statement of Direct Labor, Fringe Benefits, and General Overhead (the "Statement") of Weir Engineers and Architects, Inc. (the "Company") for the year ended December 31, 2004. This Statement is the responsibility of the Company's management. Our responsibility is to express an opinion on the Statement based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the financial audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Statement is free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the Statement of Direct Labor, Fringe Benefits, and General Overhead. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall Statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The accompanying Statement was prepared on a basis of accounting practices prescribed by Part 31 of the Federal Acquisition Regulations (FARs) and certain other Federal and state regulations as discussed in Note 2, and is not intended to be a presentation in conformity with generally accepted accounting principles.

In our opinion, the Statement referred to above presents fairly, in all material respects, the direct labor, fringe benefits, and general overhead of the Company for the year ended December 31, 2004, on the basis of accounting described in Note 2.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 3, 2005, on our consideration of the Company's internal controls and its compliance with certain provisions of laws, regulations, and contracts. The purpose of that report is to describe the scope of our testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

This report is intended solely for the use and information of the Company and government agencies or other customers related to contracts employing the cost principles of the Federal Acquisition Regulations and should not be used for any other purpose.

I.M. Auditor, CPA
April 3, 2005

Bragg, Owens, & Associates
Certified Public Accountants

Independent Auditors Report on
Compliance and Internal Controls

To the Board of Directors
Weir Engineers & Architects, Inc.

We have audited the Statement of Direct Labor, Fringe Benefits, and General Overhead of the Company for the fiscal year ended December 31, 2004, and have issued our report thereon dated April 3, 2005. We conducted our audit in accordance with generally accepted auditing standards and the financial audit standards contained in the *Government Auditing Standards* issued by the Comptroller General of the United States of America.

Compliance

As part of obtaining reasonable assurance about whether the Company's Statement is free from material misstatement, we performed tests of the Company's compliance with certain provisions of laws, regulations and contracts, including the provisions of the applicable sections of Part 31 of the Federal Acquisition Regulations, noncompliance with which could have a direct and material effect on the determination of the Statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Company's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the Statement and not to provide assurance on internal control over financial reporting. The management of the Company is responsible for establishing and maintaining internal control over financial reporting. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control over financial reporting. The objectives of internal control over financial reporting are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with the Federal Acquisition Regulations Part 31. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal controls over financial reporting in the following categories: cash disbursements and payroll.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal controls over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the use and information of the Company and government agencies or other customers related to contracts employing the cost principles of the Federal Acquisition Regulations, and should not be used for any other purpose.

I.M. Auditor, CPA
April 3, 2005

B. Statement of Direct Labor, Fringe Benefits and General Overhead

The Department prefers the designation “Statement of Direct Labor, Fringe Benefits and General Overhead” due to the increased emphasis on the requirement to specifically state the direct labor base for the audit period. The required contents and preferred format of the “Statement” are exactly the same as the “Schedule of Indirect Costs” shown on page 9 – 3 of the AASHTO Uniform Audit & Accounting Guide, reprinted in Section 3 of these *Guidelines*. Clearly, the name given to the listing of indirect costs is not a significant matter; however, when the example is not followed, the most common deviation is the omission of a clear declaration of the direct labor base.

The direct labor base, free of overtime premium, is critically important to the Department in establishing reimbursement rates. The Department “accepts” the costs shown and listed in the statement, and in the Note on direct expenses, as the consultant’s costs of doing business. Costs that are not accepted as the reasonable cost of doing business are not included in rate calculations. The reimbursement rates are established based on the accepted costs, not on the consultant’s rate proposal. Because the Department accepts direct or indirect costs, as opposed to rate proposals, audit reports proposing rates based on a distribution base other than direct labor can be accommodated and the cost pools can be considered in calculating rates. The base for calculating each rate is the direct labor base, free of overtime premium and stated in whole dollars.

The Statement of Direct Labor, Fringe Benefits and General Overhead must include columns to show amounts determined to be unallowable costs and a reference to the associated FAR provision or Florida statute. The references should be expanded in footnotes or an attachment with more complete explanations of the reasons for disallowances. Discussions of the allowability of specific items of cost under F.S. 112.061 and Part 31 of the Federal Acquisition Regulations are set forth in Section 2 of these *Guidelines* and Chapter 5 of the AASHTO Uniform Audit & Accounting Guide, reprinted in Section 3 of these *Guidelines*.

In the event the consultant is proposing rates for both the Home Office and a Field Office, the allocation of costs between the offices must be shown in detail. Again, the Department expects an allocation of costs, not a declaration of a rate. A detailed listing of Fringe Benefit costs is required, including the amount of each cost allocated between the Home and Field Offices. The Department prefers the allocation method described in Chapter 4 of the AASHTO Uniform Audit & Accounting Guide, reprinted in Section 3 of these *Guidelines*. Whether the consultant utilizes this methodology or not, the allocation outcome must be shown in whole dollars and the methodology utilized must be described in a Note to the financial statement. See Section 1, Part IV C. 5. for a further discussion of this disclosure.

Since the introduction of the Department’s direct expense rate, several consultants have submitted expanded Statements of Direct Labor, Direct Expenses, Fringe Benefits and General Overhead. Such reports presumably allow for the listing of all cost accounts

and reconciliation to the consultant's Income Statement as well as removing the need for the Note on direct expenses. Such reports are acceptable so long as the division of direct costs between the Home and Field Offices is based on reports of the cost center actually incurring the costs rather than an allocation of company-wide costs. See the further discussion of the reporting of direct expenses in Section 1, Part IV C. 6. of these *Guidelines*.

C. Assurances and Disclosures (Notes)

Although some of the following discussions reference specific Note numbers, there is no established or required sequence for the presentation of Notes to the financial statement. The required disclosures and assurances may be provided in any order deemed convenient or logical. In addition, the following listing and discussions is not intended to limit the range of Notes and disclosures management and the auditors may consider necessary or appropriate. For example, many Notes sections begin with a description of the consultant and the nature of the consultant's business. This Note is not required by any applicable law, regulation, or Departmental policy. Similarly, disclosures of depreciation methods, related party transactions, and many other subjects are often appropriate, and are required when applicable, but are not required in all Reports and, therefore, are not discussed in the following paragraphs. Example language for several such omitted Notes is included in Chapter 9 of the AASHTO Audit & Accounting Guide, reprinted in Section 3 of these *Guidelines*.

1. Basis of Accounting

Statements and schedules which have been adjusted for disallowances required by the FAR or F.S. 112.061 have not been prepared in accordance with generally accepted accounting principles. The Notes to the financial statement must include an acknowledgement of this fact. In reports submitted to the Department this Note may acknowledge Florida Statute 112.061 although the acknowledgement is not required (See Section 2 of these *Guidelines* for a discussion of F.S. 112.061). The Basis of Accounting Note must be consistent with the basis of accounting assurance made in the Independent Auditor's Report (See paragraph 3 of the Report on Page 11). The following text, or other text incorporating the same essential elements, is normally included as part of Note 2 – Basis of Accounting and Description of Accounting Systems:

The Company's policy is to prepare its overhead schedules, which support the Statement of Direct Labor, Fringe Benefits, and General Overhead, on the basis of accounting practices prescribed by Part 31 of the Federal Acquisition Regulations (FAR) and Section 112.061 of the Florida Statutes. Accordingly, the above-mentioned Statement is not intended to present the results of operations of the Company in conformity with generally accepted accounting principles.

Citation of the accounting practices prescribed by F.S. 112.061 is relevant and appreciated for audit reports which include the reporting of direct expenses. FAR compliant audits of indirect costs will be accepted, and need not cite the statute, but no Consultant will be prequalified until the direct expense information has been provided.

2. Description of Accounting System

The Notes must contain an accurate description of the type of accounting system maintained by the consultant. Consultants that bill their services measured in labor hours must maintain a job cost accounting system and should provide an assurance similar to the suggestion contained in subsection a., below.

a. Job Cost Accounting System

Florida Administrative Code 14-75.0022 (c) 1. a. requires the consultant's accounting system be adequate to support all billings made to the Department and other clients. If the consultant bills clients on the basis of labor hours, a job cost accounting system is required. The Basis of Accounting and Description of Accounting System Note to the financial statement, commonly designated Note 2, **must** contain the following text, or text containing the same essential elements, if the consultant bills for labor hours:

The Company maintains a job-order cost accounting system for the recording and accumulating of costs incurred under its contracts. Each project is assigned a job number so that costs may be segregated and accumulated in the Company's job-order cost accounting system.

b. Fee-for-Service Accounting System

If the consultant bills exclusively on a fee-for-service, unit-rate basis and maintains a published fee schedule, a formal job-cost accounting system is not required. In these circumstances the assurance provided in the Note is that the consultant charges the Department the same scheduled rate for services as they charge to other clients for the same service. When the consultant bills from a published fee schedule, the Basis of Accounting and Description of Accounting System Note should contain the following text, or text containing the same essential elements:

The Company bills exclusively on a fee-for-service, unit rate basis and maintains a published fee schedule. The Company charges FDOT the same unit rates per the fee schedule as they charge other clients for the same services.

When this or similar assurance is used, a copy of the current published fee schedule must be included with the Reimbursement

Rate Audit Report to allow for identification of deliverables as opposed to loaded labor rates.

c. Excluded Cost Reports

Consultants who, by agreement with the Department's Procurement Office and the Office of the Inspector General, have established cost-based rates for defined functions, or consultants who maintain a published fee schedule but do not bill exclusively from the schedule, must maintain a job cost accounting system for their hourly services. However, the direct costs of services billed on cost-based rates or scheduled fees, should be excluded from the calculation of direct expense rates. The accounting system description should include assurance of the segregation of the costs to deliver fee or rate based services from the costs associated with hourly services. The Basis of Accounting and Description of Accounting System Note should contain the following text, or text containing the same essential elements:

The Company maintains a job-order cost accounting system for the recording and accumulation of costs incurred under its contracts. Direct costs incurred in providing services billed to clients at unit rates or on the basis of a published fee schedule are charged by functional accounts and accumulated as a single project or grouping to allow segregation of such costs from other direct costs. Each project is assigned a job number so that costs may be segregated and accumulated in the Company's job-order cost accounting system.

3. Estimates for Pricing Purposes

Florida Administrative Code 14-75.0022 (c) 1. c. requires a statement that the consultant's method of estimating costs for proposals is consistent with the accounting system. This statement can be included as a separate Note or, more commonly, included in the Basis of Accounting and Description of Accounting System Note. If a Consultant's FAR compliant audit does not include this assurance, the Consultant will be required to provide the assurance separately. The text must be consistent with the Description of Accounting System text discussed in Section 1, Part IV C. 2., above. The following text is suggested for use with a job cost accounting system:

The Company's method of estimating costs for pricing purposes during the proposal process is consistent with the accumulation and reporting of costs under its job-order cost accounting system.

Proposal costs shown as direct costs in estimates provided to the Department must be recorded and accumulated as direct costs when

incurred. Similarly, proposed direct labor man-hours accepted in contract negotiations must be invoiced and recorded as direct labor when incurred irrespective of whether performed by employees or non-employees.

4. Accounting Treatment of Overtime

There are two disclosures which are required in relation to the accounting treatment of overtime: the consultant's policy on the treatment of uncompensated overtime and the actual reporting in the Reimbursement Rate Audit Report of incurred overtime premium costs.

a. Uncompensated Overtime

Consultants are required to describe in the Reimbursement Rate Audit Report their policy addressing uncompensated overtime. Uncompensated overtime represents hours worked by salaried employees without additional compensation or compensatory time. See additional discussion in Chapter 4 of the AASHTO Audit & Accounting Guide, reprinted in Section 3 of these *Guidelines*. There are two acceptable methods used to account for uncompensated overtime.

(1) Effective Rate Method

The "Effective Rate method requires an employee's salary per period to be divided by the total hours worked in the time period and recorded on the time sheet. This results in an effective rate which may vary according to the amount of overtime worked that pay period. This calculation must be done every pay period since the actual salary paid to the employee is recorded in the payroll records and general ledger.

This method is the Department's preferred method since it is the most accurate way to distribute labor costs based on actual hours worked.

Example of Effective Rate Method

Assume a salaried employee earns \$1,000 biweekly and normally works 80 hours in that two week period. Their normal (standard) pay rate is $\$1,000 / 80 \text{ hours} = \$12.50/\text{hr}$. If their time sheet records that they worked 20 hours of G & A, and 20 hours on each of three projects, the firm's accountant would post \$250 to the G & A indirect labor account and \$250 to each of the three projects for a total of \$750 of direct labor. A grand total of \$1,000 would be posted to labor accounts and paid to the employee.

Now assume this same employee works 100 hours in a biweekly period. Their effective rate is now $\$1,000 / 100 \text{ hours} = \$10.00/\text{hr}$. If the employee worked the same 25% in the same labor categories above, the accountant would post \$250 to the G & A indirect labor account and \$250 to each of the three projects (25 hours * \$10/hr.)

for a total of \$750 direct labor and a total of \$1,000 posted to labor accounts and paid to the employee.

The amount recorded in the books and the amount paid to the employee stays the same at \$1,000; only the hourly rate changes because the salaried employee worked more than the standard 80 hours. Remember that this method is only for employees who are not compensated for the overtime which they work (compensatory time is considered a form of compensation!).

(2) Double Variance Method

This method requires the consultant to use an employee's standard hourly rate based on the firm's standard year expressed in hours (for example, 2080 hours). The method requires establishing variance accounts in the general ledger and allocating the direct variances by job. This method is more cumbersome to apply than the "effective rate" method.

Example of Double Variance Method

Based on the same "Effective Rate" assumptions, if the salaried employee works the standard 80 hours, there will be no difference in the pay rate (\$12.50/hr.) nor in the amount recorded (\$1,000) under the Double Variance Method.

If the employee works 100 hours in a biweekly pay period, there will be differences in the amount of labor recorded but this will be reduced to the amount paid (\$1,000) by credits to the indirect labor variance account and the direct labor variance account. Using this method and assuming 25 hours each to the same 4 projects, the accountant would record \$312.50 to the G & A indirect labor account with a credit of \$250 to cash/payables and a \$62.50 credit to the indirect labor variance. Similarly, \$312.50 (25 hours * \$12.50/hr) would be recorded to each of the projects for a total of \$937.50 and corresponding credits of \$750 to cash/payables and \$187.50 to direct labor variance account. The amounts posted to labor accounts less the amounts posted to the variance accounts equals the \$1,000 actually paid to the employee, consistent with the cash/payable balance.

One final problem to be addressed is how to break down the direct variance by job (remember that the indirect variance does not have to be broken down by type of indirect labor). The amount recorded in each job using the standard rate of \$12.50/hr was \$312.50 for a total of \$937.50 for all jobs during the pay period. 33.33% of the total variance is attributable to each project charged ($\$312.50 / \937.50). Total charges to the direct labor variance account for the period were \$187.50; applying the project percentage to the variance balance, each project has a \$62.50 labor variance. When

the \$62.50 credit is netted against the \$312.50 posted, it equals \$ 250 for each job plus the \$250 net recorded for indirect labor which gives a grand total of \$1,000.

b. Reporting Overtime Premium Costs

Overtime Premium costs must be separately accumulated in accounting records and are specifically excluded from the consultant's direct labor base. The Department has taken the position that overtime premium costs are reimbursable costs of operation and may be included in direct expense and/or overhead cost listings in Reimbursement Rate Audit Reports. We anticipate that overtime hours are most commonly incurred in the performance of direct labor, therefore the costs of overtime premium will most often be reported as direct expense. If included in direct expense listings, these costs are included in the direct expense rate calculation and reimbursed based on each direct labor hour billed in future contracts.

However, the inclusion of overtime premium costs in the direct expense rate, or in overhead, made the advance negotiation and approval of overtime as an element of direct labor to be separately invoiced inappropriate as such approval would result in duplicative payment. In response to consultant objections to the preclusion of negotiated overtime, the Department has adopted a policy which allows consultants to choose the manner by which overtime premium costs will be reimbursed by the Department.

Implementation of this policy requires that each consultant include in the Reimbursement Rate Audit Report a specific Note declaring their reimbursement preference, whether or not premium overtime costs have been incurred during the audit year.

The Note must declare that overtime premium costs have been, or would have been, included in the listing of direct expenses or overhead costs, or that these costs have been excluded from both listings and are therefore not reimbursed under either the direct expense rate or the overhead rate. Only upon the Noted assurance that overtime premium costs are not reimbursed by either of the Department's reimbursement rates do consultants become eligible for the advance negotiation of overtime as an invoicable element of direct labor.

5. **Field Offices and Field Office Allocation**

Consultants are not always able to perform contracted services from their established home or branch offices. Certain contracts may require establishment of offices in field locations or the consultant may be required to locate personnel in space provided by an FDOT District Office

or other contracting authority. A Note is required stating whether the consultant maintained a Field Office during the audit period and, if so, describing the methodology utilized in the allocation of indirect costs to the Field Office.

The example and method for allocating indirect costs to a Field Office shown in Chapter 4 of the AASHTO Uniform Audit & Accounting Guide, reprinted in Section 3 of these *Guidelines*, is the Department's preferred methodology. However, the guideline methodology is not a required methodology. It is required that consultant allocations must have resulted from a reasonable and determinable allocation plan, consistently applied.

For example, specifically identified indirect expenses which directly benefit Field Offices may be allocated entirely to the Field Office overhead pool. Costs which are determined to be of no benefit to the Field Office may be, similarly, allocated entirely to the Home Office. Indirect costs benefiting the organization as a whole would be allocated between the offices using an identified, objective basis. The Departmental requirement is that the Note describe the allocation methodology used in sufficient detail that the logic and order of the "reasonable and determinable allocation plan" can be understood.

6. Direct Expense Rate

a. Background and Introduction

Reimbursement Rate Audit Reports for fiscal years ended on or after December 31, 2002, must include an audited listing of actual direct costs recorded in job cost reports and the general ledger for the audit period. All professional services contracts negotiated since October 1, 2003 have included reimbursement of direct expenses by application of a direct expenses rate based on the audit listing of direct costs in relation to the direct labor base. If the Consultant submits a FAR compliant audit report which does not include the required listing of direct expenses, the Consultant will be required to submit a supplemental schedule of these costs. Although FAR compliant audit reports, performed in compliance with *Government Auditing Standards*, will be accepted for establishment of overhead rates, no Consultant will be prequalified by the Department until the report of direct expenses is received.

The direct costs incurred under a contract with the Department will be reimbursed as one of three component parts of total direct costs: negotiated direct labor, including employees and non-employees fulfilling the contractor's man-hour commitments; subcontracts and extraordinary items reimbursed as pass through costs on the basis of specific invoices; or on the basis of the pre-established direct expense rate, paid as a consequence of the invoicing of direct labor. With the exception of direct labor, extraordinary costs, and

the costs of subcontracted work, the Department no longer reimburses the direct costs of professional services contracts based on invoiced actual costs. Nor does the Department commonly negotiate and contract to pay lump sum estimates of direct costs to be incurred under contracts.

Separate direct expense listings, and separate reimbursement rates, are required for Home and Field Offices. Field Office direct expenses may represent direct costs incurred in Field Offices on a corporate wide basis or costs incurred within a smaller cost center encompassing, at a minimum, all contracts and operations within the State of Florida. The cost center, or cost centers, representing the Field Office must be the same for determination and reporting of Field Office direct labor, overhead expenses, and Field Office direct costs. Field Office direct costs are to be accumulated and reported from job cost records for projects associated with Field Office operations or from separately maintained general ledger accounts for Field Office cost centers and are to represent the direct costs actually incurred by the Field Office. Allocation between the cost centers of general ledger balances common to both the Home and Field Offices is not acceptable as such allocation will not reflect the direct charges actually incurred by either cost center. The Department recommends maintenance of separate general ledger accounts for the various Home Office and Field Office direct expenses. Direct expense listings are to be tested for allowability in accordance with the Federal Acquisition Regulations and are to exclude costs in excess of the per diem and travel expenses specified in Florida Statute 112.061 (See discussion in Section 2 of these *Guidelines*).

b. Accounting / Auditing Requirements

1. The direct expenses recorded in the general ledger must agree with the amounts posted in the job cost ledgers. Maintenance of separate general ledger accounts for Home Office and Field Office direct expenses is advised. Periodic reconciliation of job cost ledgers and the general ledger should be performed.
2. Actual costs must be posted to the job cost records despite the fact that the Florida Department of Transportation will reimburse direct expenses based on the pre-established direct expense rate determined from historical costs in the previous audit period. The incurrence, payment, and recording of costs is not to be effected by the current revenue stream.
3. Accounting for CADD, computer costs, and other costs formerly billed at established rates, must be consistent with the company's policies and procedures. If formerly billed as a direct project expense, these costs should be included in the direct

expense listings and reimbursed as part of the direct expense rate but may be included, without duplication, as indirect costs and reimbursed in the overhead rate. These expenses will not be reimbursed as a separate, invoiced cost.

4. Unusual and infrequently occurring items of direct expense which represent a significant percentage of a particular contract's total direct expenses may be negotiated as extraordinary expenses and reimbursed as pass through costs on the basis of invoiced actual cost. The minimum threshold for significant cost in considering requests for extraordinary expense treatment is currently \$10,000. When such extraordinary expenses are reimbursed separately, these costs must be excluded from the direct expense pool reported for use in establishing future audit-based direct expense rates.
5. Direct expenses reported in Reimbursement Rate Audit Reports must be tested for the allowability of the costs in accordance with the Federal Acquisition Regulations (Part 31) and exclude costs in excess of the per diem and travel expenses allowed in Florida Statute 112.061.
6. For consultants maintaining Field Offices, a separate direct expense rate, and a separate listing of direct expenses, will be required for Home Office direct expenses and Field Office direct expenses. Direct expenses must be reported for the office actually incurring the costs and allocation between the Home and Field Offices of direct expenses accumulated in common general ledger accounts is not acceptable.
7. Subcontract costs and contract labor or consultants performing direct labor functions are considered as pass through direct expenses paid based on invoiced actual costs and are to be excluded from direct expense listings used in the calculation of direct expense rates.
8. The CPA's audit testing program should test the identification and proper recording of both direct costs and indirect costs.
9. When reporting direct costs incurred in an accounting system in which the consultant bills clients for cost-based rates or bills partially on a fee-for-service basis using a published fee schedule for some services, the costs incurred in providing the cost-based or fee schedule service must be segregated and reported separately in the Reimbursement Rate Audit Report. In the Note listing direct expenses and proposing a direct expense rate, the direct labor cost of providing services billed on a cost-based rate or scheduled fee basis must be subtracted from the consultant's direct labor base. The non-labor costs associated with providing services billed on a cost-based rate or

scheduled fee basis may not be included in the direct expenses listing for purposes of establishing a direct expense rate for the audit period.

c. Reporting Direct Expenses / Direct Expense Rate

The Note to the financial statement containing the direct expenses disclosure, or the Supplemental Schedule of Direct Costs required if the audit report does not include the Note, must include a listing of the direct expenses, a statement of the costs disallowed, a total of allowable direct expenses, the direct labor base, and the proposed direct expense rate for the audit period. Depending on the format utilized, explanatory text may be needed to identify and report extraordinary items or subcontract costs which were excluded, the basis for determinations of unallowability, and other matters aiding understanding of the report. The two-column example Note provided is the simplest acceptable format, both for the Note and for the supplemental schedule. Multiple-column formats are also acceptable, and preferred. If it is necessary to present both a Home Office and a Field Office direct expense listing, multiple column formats are recommended although successive presentation of the example format is acceptable. Multiple column formats may also have an advantage in indicating the accounts found to contain unallowable costs. An indication of the amount of unallowable costs is very important, regardless of the format used. A report of zero (\$0.00) unallowable costs provides a clear indication the review was performed. If the zero is not shown, a narrative statement that a review was performed is needed. An example of an acceptable disclosure of direct expenses is shown at the top of page 24.

Note 7 – Direct Expense Rate

The company's home office direct expense rate was based on the direct costs accumulated in the job cost records and recorded in the following accounts in the general ledger.

<u>Home Direct Expenses</u>	<u>Amount</u>
Travel	\$ 5,000
Telephone	\$ 1,500
Copying & Printing	\$ 3,500
Postage & Delivery	\$ 1,000
Equipment	\$ 7,500
Vehicle Rental	\$ 6,000
Employee Mileage	\$ 1,500
CADD Charges	<u>\$ 8,000</u>
Total Direct Costs	\$34,000
Unallowable Costs *	<u>\$ 2,000</u>
Allowable Expenses	\$32,000
Direct Labor	\$145,000
Direct Expense Rate	22.07%

The Company had extraordinary items such as barge rental cost of \$75,000 and SUE operation costs of \$56,357 that is not included in the direct expenses listing.

* The unallowable costs that were removed from the direct expenses were costs in excess of the per diem and travel expenses allowed in Florida Statute 112.061. *(Or please specify the appropriate FAR provision)*

7. Facilities Capital Cost of Money

The Department reimburses the facilities capital cost of money with no requirement to demonstrate that any particular facility will be utilized in carrying out a specific contract with the Department. Therefore, the required Note need only state the average net book value of capital assets during the audit year. Only the net book value (cost – accumulated depreciation) of capitalized assets may be used. The FCCM rate is in addition to depreciation expense, normally taken as an overhead cost; the computed cost of money supports the FCCM rate only and may not be included in the overhead pool.

There is a single FCCM rate for each consultant as a whole. The average net book value of capitalized assets is multiplied by the average Prompt Payment Act Interest Rate for the twelve months of the audit period to produce the computed facilities capital cost of money for the period. The facilities capital cost of money is then divided by the total direct labor base (Home + Field) for the consultant to yield the FCCM rate, expressed in thousandths of a percent (5 decimal places). The example disclosure Note shown below differs very slightly from the example provided on page 9 – 9 of the AASHTO Audit & Accounting Guide, reprinted in Section 3 of these *Guidelines*. Communication of the required information is the only requirement. Many CPA firms simply declare the FCCM rate they have computed. This practice will continue to be acceptable, but the Department prefers a statement of the average net book value of capitalized assets so that the monthly interest rates utilized can be checked.

Note 8 – Facilities Capital Cost of Money (FCCM)

The Facilities Capital Cost of Money Rate has been calculated in accordance with FAR Section 31.205-10, using average net book values of equipment and facilities multiplied by the average Treasury rates for the applicable period, as shown:

Beginning net capital assets	\$40,000
Net capital assets, 12/31/___	<u>\$50,000</u>
Total	\$90,000
	<u> /2 </u>
Average Net Capital Assets	\$45,000
Average Treasury Rate	<u> 3.688% </u>
Facilities Capital Cost of Money	\$ 1,659
Direct Labor Base	\$145,000
FCCM Rate (1659/145000)	<u>1.144%</u>

Part V – Minor Projects / Self-Certifications

Consultants requesting qualification for minor projects only, with contract fees under \$250,000, or consultants qualifying solely to perform appraisal services or to prepare or review business damage estimates under Work Groups 20 or 22, are not required to submit an audit report or to request an accounting system review. Consultants prequalified only for minor projects are said to have “limited” contracting authority and need not have pre-established reimbursement rates at the time they enter contract negotiations with the Department. Each contracting authority within the Department

may negotiate reimbursement rates appropriate for the specific contract being negotiated with a consultant having limited contracting authority.

Consultants with limited contracting authority but nonetheless desiring to pre-establish reimbursement rates for presentation to the Department during contract negotiations may submit a self-certified reimbursement rate request to the Department's Procurement Office. This request must contain the same cost information presented in a Reimbursement Rate Audit Report, but must be certified by a principal of the firm rather than a Certified Public Accountant. Overhead and FCCM rates established following review of a self-certified reimbursement rate request are subject to the currently established maximum cap rates based on the Department's review of average audited reimbursement rates. Direct expense rates will be based on the self-certified reimbursement rate request, subject to further negotiation for individual contracts. Current maximum caps for the Department's reimbursement rates are found on the Procurement Office website at www.dot.state.fl.us/procurement/news.htm. Self-certified reimbursement rate requests may be reviewed by the Procurement Office or forwarded to the Office of Inspector General for review.

If the consultant with limited contracting authority has not acted to pre-establish reimbursement rates prior to entering contract negotiations with a Department contracting authority, the contracting authority may require the consultant to complete and submit a self-certified reimbursement rate request. The contracting authority may review the request and establish reimbursement rates, or they may forward the report to the Office of Inspector General for review. Whether submitted by the consultant through the Procurement Office or forwarded from a contracting authority, the Office of Inspector General will prepare a report of the reimbursement rates supported by the financial information included with the self-certified reimbursement rate request. The OIG report will be distributed to the consultant and the requesting Department authority. Reimbursement rates established in an OIG review will be posted and made available for use by all Department contracting authorities.

Self-Certification of Accounting System and Reimbursement Rates

Self-certified reimbursement rate requests are to be prepared in the format entitled "Self-Certification of Accounting System and Reimbursement Rates" shown on pages 24 and 25, following. Page 1 of the format is a questionnaire concerning the consultant's accounting system and related information. Page 2 provides spaces to enter the reimbursement rates proposed by the consultant, including: a declaration of a period ended date within 16 months of the certification date; the direct labor base for that period; the consultant's proposed fringe benefit rate, general overhead rate, and combined overhead rate; the proposed direct expense rate; and the average net book value of capitalized assets. Page 2 also includes space for the signed certification of the information submitted by a principal of the firm. Additional sheets must be attached listing the indirect and direct expenses supporting the consultant's rate calculations.

SELF-CERTIFICATION OF ACCOUNTING SYSTEM AND REIMBURSEMENT RATES

Consultants Name:	_____	Federal ID Number:	_____
Contact Person:	_____	Phone Number:	_____
	_____	E-Mail:	_____
Qualifying For:	Minor Projects (Under \$250,000)	<input type="checkbox"/>	
Or:	Work Group 20 or 22	<input type="checkbox"/>	

Accounting Questionnaire

1. General:

Fiscal Year used by firm? _____

Statements on cash or accrual basis? _____

2. Labor Costs (Time Sheets)

Yes or No
Response

Do all employees keep time sheets?	_____
Do time sheets indicate project and overhead accounts?	_____
Do employees sign time sheets?	_____
Are time sheets reviewed and signed by supervisors?	_____
Are payroll expenditures distributed to appropriate accounts based on time sheets?	_____
Are payroll records prepared for every pay period?	_____

3. Work Logs (For work billed as cost per unit of work)

Do work logs identify the project?	_____
Are work logs maintained for all projects?	_____

4. Expenditures

Are all expenditures identified and recorded in the General Ledger as overhead or direct costs?	_____
Are direct costs identified as direct charges to projects regardless of eligibility for reimbursement?	_____

5. Accounting for Costs and Expenses

Does the General Ledger separate direct cost from indirect (overhead)?	_____
Is a job cost ledger or cost report maintained for every project?	_____

6. Estimating Costs for Price Proposals

Is the method of estimating costs for pricing purposes consistent with the accumulation and reporting of costs under your job cost system?	_____
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Reimbursement Rate Audit Guidelines, 2005, Section 1
Florida Department of Transportation

SELF-CERTIFICATION OF ACCOUNTING SYSTEM AND REIMBURSEMENT RATES

RATE SUMMARY FOR YEAR ENDING: _____

Reimbursement rates are calculated by dividing total allowable costs by total direct labor costs. For these calculations, certain direct or indirect expenses, such as travel, mileage, interest, certain advertising costs, etc., must be limited or excluded in accordance with Florida Statute 112.061 or Federal Acquisition Regulations, sub Part 31.2. These regulations may be viewed on the Internet at www.arnet.gov/far/. If a field office is needed, a separate determination should be performed.

<u>Description</u>	Home Office	Field Office
Direct Labor Base	\$ _____	\$ _____
Fringe Benefit Rate	_____ %	_____ %
General Overhead Rate	_____ %	_____ %
Combined Overhead Rate	_____ %	_____ %
Direct Expense Rate	_____ %	_____ %

A listing of the fringe benefits and general overhead costs utilized in calculating the overhead rates shown above and a listing of the direct expenses utilized in calculating the direct expense rate shown above must be attached to this certification with any excluded items identified.

COMPUTATION OF FACILITIES CAPITAL COST OF MONEY (FCCM)

	Balance Start of FY	Balance End of FY
Net Capital Assets	\$ _____	\$ _____
<u>Average Net Book Value</u> (required)	\$ _____	
Average US Treasury Rate	_____ %	
Facilities capital Cost (Average x Rate)	\$ _____	
Direct Labor Base for Fiscal Year	\$ _____	
FCCM Rate (Cost/Direct Labor)	_____ %	

CERTIFICATION

It is hereby certified that the accounting system for this firm meets the minimum requirements set forth in Department Guidelines and that all information contained hereon, including attachments, is true and correct.

(Signature)

(Date)

(Name and Title)

(Company Name)

SECTION 2

FLORIDA STATUTE

112.061

Per Diem and Travel Expenses

FDOT Reimbursement of Per Diem and Travel Expenses

Florida Statute 112.061 sets the maximum reimbursement limits for Per Diem and Travel Expenses for public employees and “Authorized persons”, including Consultants and Contractors working under professional services contracts with the Florida Department of Transportation. Although travel expenses are no longer reimbursed based on submission of travel vouchers as costs are incurred, the maximum reimbursement limits continue to apply. In establishing both the overhead and direct expense reimbursement rates, the Department now relies on appropriate adjustment of the recorded costs of travel in the preparation of the CPA issued Reimbursement Rate Audit Reports, particularly with respect to direct expenses.

The reimbursement limitations contained in F.S. 112.061 have been a prescribed “basis of accounting practice” for preparation of Rate Audit reports and are, generally, more restrictive than similar limitations referenced in the FAR, Section 31.205-46.

Nonetheless, FAR compliant audits of indirect costs and overhead rates will be accepted by the Department. Reports of direct expenses continue to require adjustment of expenses to the limits provided in the statute. The Independent Auditor’s Report commonly, almost uniformly, contains the following or similar assurance:

“The accompanying statement was prepared on the basis of accounting practices prescribed by Part 31 of the Federal Acquisition Regulations and certain other federal and state regulations, as discussed in Note ?, and is not intended to be a presentation in conformity with generally accepted accounting principles.”
(*emphasis added*).

The “Basis of Accounting” discussion in the Notes, however designated, must be consistent. See further discussion in Section 1, Part IV C. 1. of these *Guidelines*.

It is the Department’s position that the presence of the required assurance and reference is a declaration that amounts reported for per diem, travel expenses, mileage and other travel related costs appearing in either the indirect or direct cost listings in the Rate Audit report have been appropriately adjusted to the amounts which would have been reimbursed if subject to the statute’s limitations. The Certified Public Accountant issuing such a report must maintain workpapers demonstrating their consideration of the limits of F.S. 112.061 in relation to recorded costs in preparing the report.

Florida Statute 112.061, as amended through the 2005 legislative session, is reprinted below. F.S. 112.061(6) sets maximum reimbursement limits for per diem and subsistence. A traveler may be reimbursed either: 1. fifty dollars per diem; OR 2. the actual expenses for single-occupancy lodging plus twenty-one dollars for meals. As a practical matter per diem is only claimed for the final day of a travel period, when no lodging costs are incurred. F.S. 112.061(7)(d) limits mileage reimbursements to 29 cents per mile. With the exception of firms which predominantly contract with Florida government agencies or local governments and use the statutory limits in their regular business operations, the Department normally expects travel costs, especially direct travel costs, shown in Rate Audit reports will have been adjusted down from the costs actually paid.

112.061 Per diem and travel expenses of public officers, employees, and authorized persons.--

(1) LEGISLATIVE INTENT.--There are inequities, conflicts, inconsistencies, and lapses in the numerous laws regulating or attempting to regulate travel expenses of public officers, employees, and authorized persons in the state. It is the intent of the Legislature:

(a) To remedy same and to establish uniform maximum rates, and limitations, with certain justifiable exceptions, applicable to all public officers, employees, and authorized persons whose travel expenses are paid by a public agency.

(b) To preserve the standardization and uniformity established by this law:

1. The provisions of this section shall prevail over any conflicting provisions in a general law, present or future, to the extent of the conflict; but if any such general law contains a specific exemption from this section, including a specific reference to this section, such general law shall prevail, but only to the extent of the exemption.

2. The provisions of any special or local law, present or future, shall prevail over any conflicting provisions in this section, but only to the extent of the conflict.

(2) DEFINITIONS.--For the purposes of this section, the following words shall have the meanings indicated:

(a) Agency or public agency--Any office, department, agency, division, subdivision, political subdivision, board, bureau, commission, authority, district, public body, body politic, county, city, town, village, municipality, or any other separate unit of government created pursuant to law.

(b) Agency head or head of the agency--The highest policymaking authority of a public agency, as herein defined.

(c) Officer or public officer--An individual who in the performance of his or her official duties is vested by law with sovereign powers of government and who is either elected by the people, or commissioned by the Governor and has jurisdiction extending throughout the state, or any person lawfully serving instead of either of the foregoing two classes of individuals as initial designee or successor.

(d) Employee or public employee--An individual, whether commissioned or not, other than an officer or authorized person as defined herein, who is filling a regular or full-time authorized position and is responsible to an agency head.

(e) Authorized person--

1. A person other than a public officer or employee as defined herein, whether elected or commissioned or not, who is authorized by an agency head to incur travel expenses in the performance of official duties.

2. A person who is called upon by an agency to contribute time and services as consultant or adviser.

3. A person who is a candidate for an executive or professional position.

(f) Traveler--A public officer, public employee, or authorized person, when performing authorized travel.

(g) Travel expense, traveling expenses, necessary expenses while traveling, actual expenses while traveling, or words of similar nature--The usual ordinary and incidental expenditures necessarily incurred by a traveler.

(h) Common carrier--Train, bus, commercial airline operating scheduled flights, or rental cars of an established rental car firm.

(i) Travel day--A period of 24 hours consisting of four quarters of 6 hours each.

(j) Travel period--A period of time between the time of departure and time of return.

(k) Class A travel--Continuous travel of 24 hours or more away from official headquarters.

(l) Class B travel--Continuous travel of less than 24 hours which involves overnight absence from official headquarters.

(m) Class C travel--Travel for short or day trips where the traveler is not away from his or her official headquarters overnight.

(n) Foreign travel--Travel outside the United States.

(3) AUTHORITY TO INCUR TRAVEL EXPENSES.--

(a) All travel must be authorized and approved by the head of the agency, or his or her designated representative, from whose funds the traveler is paid. The head of the agency shall not authorize or approve such a request unless it is accompanied by a signed statement by the traveler's supervisor stating that such travel is on the official business of the state and also stating the purpose of such travel.

(b) Travel expenses of travelers shall be limited to those expenses necessarily incurred by them in the performance of a public purpose authorized by law to be performed by the agency and must be within the limitations prescribed by this section.

(c) Travel by public officers or employees serving temporarily in behalf of another agency or partly in behalf of more than one agency at the same time, or authorized persons who are called upon to contribute time and services as consultants or advisers, may be authorized by the agency head. Complete explanation and justification must be shown on the travel expense voucher or attached thereto.

(d) Travel expenses of public employees for the sole purpose of taking merit system or other job placement examinations, written or oral, shall not be allowed under any circumstances, except that upon prior written approval of the agency head or his or her designee, candidates for executive or professional positions may be allowed travel expenses pursuant to this section.

(e) The agency head, or a designated representative, may pay by advancement or reimbursement, or a combination thereof, the costs of per diem of travelers and authorized persons for foreign travel at the current rates as specified in the federal publication "Standardized Regulations (Government Civilians, Foreign Areas)" and incidental expenses as provided in this section.

(f) A traveler who becomes sick or injured while away from his or her official headquarters and is therefore unable to perform the official business of the agency may continue to receive subsistence as provided in subsection (6) during this period of illness or injury until such time as he or she is able to perform the official business of the agency or returns to his or her official headquarters, whichever is earlier. Such subsistence may be paid when approved by the agency head or his or her designee.

(g) The secretary of the Department of Health or a designee may authorize travel expenses incidental to the rendering of medical services for and on behalf of clients of the Department of Health. The Department of Health may establish rates lower than the maximum provided in this section for these travel expenses.

(4) OFFICIAL HEADQUARTERS.--The official headquarters of an officer or employee assigned to an office shall be the city or town in which the office is located except that:

(a) The official headquarters of a person located in the field shall be the city or town nearest to the area where the majority of the person's work is performed, or such other city, town, or area as may be designated by the agency head provided that in all cases such designation must be in the best interests of the agency and not for the convenience of the person.

(b) When any state employee is stationed in any city or town for a period of over 30 continuous workdays, such city or town shall be deemed to be the employee's official headquarters, and he or she shall not be allowed per diem or subsistence, as provided in this section, after the said period of 30 continuous workdays has elapsed, unless this period of time is extended by the express approval of the agency head or his or her designee.

(c) A traveler may leave his or her assigned post to return home overnight, over a weekend, or during a holiday, but any time lost from regular duties shall be taken as annual leave and authorized in the usual manner. The traveler shall not be reimbursed for travel expenses in excess of the established rate for per diem allowable had he or she remained at his or her assigned post. However, when a traveler has been temporarily assigned away from his or her official headquarters for an approved period extending beyond 30 days, he or she shall be entitled to reimbursement for travel expenses at the established rate of one round trip for each 30-day period actually taken to his or her home in addition to pay and allowances otherwise provided.

(5) COMPUTATION OF TRAVEL TIME FOR REIMBURSEMENT.--For purposes of reimbursement and methods of calculating fractional days of travel, the following principles are prescribed:

(a) The travel day for Class A travel shall be a calendar day (midnight to midnight). The travel day for Class B travel shall begin at the same time as the travel period. For Class A and Class B travel, the traveler shall be reimbursed one-fourth of the authorized rate of per diem for each quarter, or fraction thereof, of the travel day included within the travel period. Class A and Class B travel shall include any assignment on official business outside of regular office hours and away from regular places of employment when it is considered reasonable and necessary to stay overnight and for which travel expenses are approved.

(b) A traveler shall not be reimbursed on a per diem basis for Class C travel, but shall receive subsistence as provided in this section, which allowance for meals shall be based on the following schedule:

1. Breakfast--When travel begins before 6 a.m. and extends beyond 8 a.m.
2. Lunch--When travel begins before 12 noon and extends beyond 2 p.m.
3. Dinner--When travel begins before 6 p.m. and extends beyond 8 p.m., or when travel occurs during nighttime hours due to special assignment.

No allowance shall be made for meals when travel is confined to the city or town of the official headquarters or immediate vicinity; except assignments of official business outside the traveler's regular place of employment if travel expenses are approved. The Chief Financial Officer shall establish a schedule for processing Class C travel subsistence payments at least on a monthly basis.

¹(c) For the 2004-2005 fiscal year only and notwithstanding the other provisions of this subsection, for Class C travel, a state traveler shall not be reimbursed on a per diem basis nor shall a traveler receive subsistence allowance. This paragraph expires July 1, 2005.

(6) RATES OF PER DIEM AND SUBSISTENCE ALLOWANCE.--For purposes of reimbursement rates and methods of calculation, per diem and subsistence allowances are divided into the following groups and rates:

(a) All travelers shall be allowed for subsistence when traveling to a convention or conference or when traveling within or outside the state in order to conduct bona fide state business, which convention, conference, or business serves a direct and lawful public purpose with relation to the public agency served by the person attending such meeting or conducting such business, either of the following for each day of such travel at the option of the traveler:

1. Fifty dollars per diem; or
2. If actual expenses exceed \$50, the amounts permitted in paragraph (b) for meals, plus actual expenses for lodging at a single-occupancy rate to be substantiated by paid bills therefore.

When lodging or meals are provided at a state institution, the traveler shall be reimbursed only for the actual expenses of such lodging or meals, not to exceed the maximum provided for in this subsection.

(b) All travelers shall be allowed the following amounts for subsistence while on Class C travel on official business as provided in paragraph (5)(b):

1. Breakfast \$3
2. Lunch \$6
3. Dinner 12

(c) No one, whether traveling out of state or in state, shall be reimbursed for any meal or lodging included in a convention or conference registration fee paid by the state.

¹(d) For the 2004-2005 fiscal year only and notwithstanding the other provisions of this subsection, for Class C travel, a state traveler shall not be reimbursed on a per diem basis nor shall a traveler receive subsistence allowance. This paragraph expires July 1, 2005.

(7) TRANSPORTATION.--

(a) All travel must be by a usually traveled route. In case a person travels by an indirect route for his or her own convenience, any extra costs shall be borne by the traveler; and reimbursement for expenses shall be based only on such charges as would have been incurred by a usually traveled route. The agency head or his or her

designee shall designate the most economical method of travel for each trip, keeping in mind the following conditions:

1. The nature of the business.
 2. The most efficient and economical means of travel (considering time of the traveler, impact on the productivity of the traveler, cost of transportation, and per diem or subsistence required). When it is more efficient and economical to either the traveler or the agency head, jet service offered by any airline, whether on state contract or not, may be used when the cost is within an approved threshold determined by the agency head or his or her designee.
 3. The number of persons making the trip and the amount of equipment or material to be transported.
- (b) The Department of Financial Services may provide any form it deems necessary to cover travel requests for traveling on official business and when paid by the state.
- (c) Transportation by common carrier when traveling on official business and paid for personally by the traveler, shall be substantiated by a receipt therefor. Federal tax shall not be reimbursable to the traveler unless the state and other public agencies are also required by federal law to pay such tax. In the event transportation other than the most economical class as approved by the agency head is provided by a common carrier on a flight check or credit card, the charges in excess of the most economical class shall be refunded by the traveler to the agency charged with the transportation provided in this manner.
- (d)1. The use of privately owned vehicles for official travel in lieu of publicly owned vehicles or common carriers may be authorized by the agency head or his or her designee. Whenever travel is by privately owned vehicle, the traveler shall be entitled to a mileage allowance at a fixed rate of 25 cents per mile for state fiscal year 1994-1995 and 29 cents per mile thereafter or the common carrier fare for such travel, as determined by the agency head. Reimbursement for expenditures related to the operation, maintenance, and ownership of a vehicle shall not be allowed when privately owned vehicles are used on public business and reimbursement is made pursuant to this paragraph, except as provided in subsection (8).
2. All mileage shall be shown from point of origin to point of destination and, when possible, shall be computed on the basis of the current map of the Department of Transportation. Vicinity mileage necessary for the conduct of official business is allowable but must be shown as a separate item on the expense voucher.
- (e) Transportation by chartered vehicles when traveling on official business may be authorized by the agency head when necessary or where it is to the advantage of the agency, provided the cost of such transportation does not exceed the cost of transportation by privately owned vehicle pursuant to paragraph (d).

(f) The agency head or his or her designee may grant monthly allowances in fixed amounts for use of privately owned automobiles on official business in lieu of the mileage rate provided in paragraph (d). Allowances granted pursuant to this paragraph shall be reasonable, taking into account the customary use of the automobile, the roads customarily traveled, and whether any of the expenses incident to the operation, maintenance, and ownership of the automobile are paid from funds of the agency or other public funds. Such allowance may be changed at any time, and shall be made on the basis of a signed statement of the traveler, filed before the allowance is granted or changed, and at least annually thereafter. The statement shall show the places and distances for an average typical month's travel on official business, and the amount that would be allowed under the approved rate per mile for the travel shown in the statement, if payment had been made pursuant to paragraph (d).

(g) No contract may be entered into between a public officer or employee, or any other person, and a public agency, in which a depreciation allowance is used in computing the amount due by the agency to the individual for the use of a privately owned vehicle on official business; provided, any such existing contract shall not be impaired.

(h) No traveler shall be allowed either mileage or transportation expense when gratuitously transported by another person or when transported by another traveler who is entitled to mileage or transportation expense. However, a traveler on a private aircraft shall be reimbursed the actual amount charged and paid for the fare for such transportation up to the cost of a commercial airline ticket for the same flight, even though the owner or pilot of such aircraft is also entitled to transportation expense for the same flight under this subsection.

(8) OTHER EXPENSES.--

(a) The following incidental travel expenses of the traveler may be reimbursed:

1. Taxi fare.
2. Ferry fares; and bridge, road, and tunnel tolls.
3. Storage or parking fees.
4. Communication expense.
5. Convention registration fee while attending a convention or conference which will serve a direct public purpose with relation to the public agency served by the person attending such meetings. A traveler may be reimbursed the actual and necessary fees for attending events which are not included in a basic registration fee that directly enhance the public purpose of the participation of the agency in the conference. Such expenses may include, but not be limited to, banquets and other meal functions. It shall be the responsibility of the traveler to substantiate that the charges were proper and

necessary. However, any meals or lodging included in the registration fee will be deducted in accordance with the allowances provided in subsection (6).

(b) Other expenses which are not specifically authorized by this section may be approved by the Department of Financial Services pursuant to rules adopted by it. Expenses approved pursuant to this paragraph shall be reported by the Department of Financial Services to the Auditor General annually.

(9) RULES.--

(a) The Department of Financial Services shall adopt such rules, including, but not limited to, the general criteria to be used by a state agency to predetermine justification for attendance by state officers and employees and authorized persons at conventions and conferences, and prescribe such forms as are necessary to effectuate the purposes of this section. The department may also adopt rules prescribing the proper disposition and use of promotional items and rebates offered by common carriers and other entities in connection with travel at public expense; however, before adopting such rules, the department shall consult with the appropriation committees of the Legislature.

(b) Each state agency shall adopt such additional specific rules and specific criteria to be used by it to predetermine justification for attendance by state officers and employees and authorized persons at conventions and conferences, not in conflict with the rules of the Department of Financial Services or with the general criteria to be used by a state agency to predetermine justification for attendance by state officers and employees and authorized persons at conventions, as may be necessary to effectuate the purposes of this section.

(10) FRAUDULENT CLAIMS.--Claims submitted pursuant to this section shall not be required to be sworn to before a notary public or other officer authorized to administer oaths, but any claim authorized or required to be made under any provision of this section shall contain a statement that the expenses were actually incurred by the traveler as necessary travel expenses in the performance of official duties and shall be verified by a written declaration that it is true and correct as to every material matter; and any person who willfully makes and subscribes any such claim which he or she does not believe to be true and correct as to every material matter, or who willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under the provisions of this section of a claim which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such claim, is guilty of a misdemeanor of the second degree, punishable as provided in s. [775.082](#) or s. [775.083](#). Whoever shall receive an allowance or reimbursement by means of a false claim shall be civilly liable in the amount of the overpayment for the reimbursement of the public fund from which the claim was paid.

(11) TRAVEL AUTHORIZATION AND VOUCHER FORMS.--

(a) *Authorization forms.*--The Department of Financial Services shall furnish a uniform travel authorization request form which shall be used by all state officers and employees and authorized persons when requesting approval for the performance of travel to a convention or conference. The form shall include, but not be limited to, provision for the name of each traveler, purpose of travel, period of travel, estimated cost to the state, and a statement of benefits accruing to the state by virtue of such travel. A copy of the program or agenda of the convention or conference, itemizing registration fees and any meals or lodging included in the registration fee, shall be attached to, and filed with, the copy of the travel authorization request form on file with the agency. The form shall be signed by the traveler and by the traveler's supervisor stating that the travel is to be incurred in connection with official business of the state. The head of the agency or his or her designated representative shall not authorize or approve such request in the absence of the appropriate signatures. A copy of the travel authorization form shall be attached to, and become a part of, the support of the agency's copy of the travel voucher.

(b) *Voucher forms.*--

1. The Department of Financial Services shall furnish a uniform travel voucher form which shall be used by all state officers and employees and authorized persons when submitting travel expense statements for approval and payment. No travel expense statement shall be approved for payment by the Chief Financial Officer unless made on the form prescribed and furnished by the department. The travel voucher form shall provide for, among other things, the purpose of the official travel and a certification or affirmation, to be signed by the traveler, indicating the truth and correctness of the claim in every material matter, that the travel expenses were actually incurred by the traveler as necessary in the performance of official duties, that per diem claimed has been appropriately reduced for any meals or lodging included in the convention or conference registration fees claimed by the traveler, and that the voucher conforms in every respect with the requirements of this section. The original copy of the executed uniform travel authorization request form shall be attached to the uniform travel voucher on file with the respective agency.

2. Statements for travel expenses incidental to the rendering of medical services for and on behalf of clients of the Department of Health shall be on forms approved by the Department of Financial Services.

(12) *ADVANCEMENTS.*--Notwithstanding any of the foregoing restrictions and limitations, an agency head or his or her designee may make, or authorize the making of, advances to cover anticipated costs of travel to travelers. Such advancements may include the costs of subsistence and travel of any person transported in the care or custody of the traveler in the performance of his or her duties.

(13) *DIRECT PAYMENT OF EXPENSES BY AGENCY.*--Whenever an agency requires an employee to incur either Class A or Class B travel on emergency notice to the traveler, such traveler may request the agency to pay his or her expenses for meals

and lodging directly to the vendor, and the agency may pay the vendor the actual expenses for meals and lodging during the travel period, limited to an amount not to exceed that authorized pursuant to this section. In emergency situations, the agency head or his or her designee may authorize an increase in the amount paid for a specific meal, provided that the total daily cost of meals does not exceed the total amount authorized for meals each day. The agency head or his or her designee may also grant prior approval for a state agency to make direct payments of travel expenses in other situations that result in cost savings to the state, and such cost savings shall be documented in the voucher submitted to the Chief Financial Officer for the direct payment of travel expenses. The provisions of this subsection shall not be deemed to apply to any legislator or to any employee of the Legislature.

(14) APPLICABILITY TO COUNTIES, COUNTY OFFICERS, DISTRICT SCHOOL BOARDS, AND SPECIAL DISTRICTS.--

(a) Rates that exceed the maximum travel reimbursement rates for nonstate travelers specified in paragraph (6)(a) for per diem, in paragraph (6)(b) for subsistence, and in subparagraph (7)(d)1. for mileage may be established by:

1. The governing body of a county by the enactment of an ordinance or resolution;
2. A county constitutional officer, pursuant to s. 1(d), Art. VIII of the State Constitution, by the establishment of written policy;
3. The governing body of a district school board by the adoption of rules; or
4. The governing body of a special district, as defined in s. [189.403](#)(1), except those special districts that are subject to s. [166.021](#)(10), by the enactment of a resolution.

(b) Rates established pursuant to paragraph (a) must apply uniformly to all travel by the county, county constitutional officer and entity governed by that officer, district school board, or special district.

(c) Except as otherwise provided in this subsection, counties, county constitutional officers and entities governed by those officers, district school boards, and special districts, other than those subject to s. [166.021](#)(10), remain subject to the requirements of this section.

History.--ss. 1, 3, ch. 22830, 1945; ss. 1, 2, 3, ch. 23892, 1947; ss. 1, 3, ch. 25040, 1949; ss. 1, 3, ch. 26910, 1951; s. 1, ch. 28303, 1953; s. 1, ch. 29628, 1955; s. 1, ch. 57-230; s. 1, ch. 61-183; s. 1, ch. 61-43; s. 1, ch. 63-5; s. 1, ch. 63-192; s. 1, ch. 63-122; s. 1, ch. 63-400; ss. 2, 3, ch. 67-371; ss. 1, 2, ch. 67-2206; s. 1, ch. 69-193; s. 1, ch. 69-381; ss. 12, 23, 31, 35, ch. 69-106; s. 65, ch. 71-136; s. 1, ch. 72-213; s. 1, ch. 72-217; s. 1, ch. 72-324; s. 26, ch. 72-404; s. 1, ch. 73-169; s. 1, ch. 74-15; s. 1, ch. 74-246; s. 1, ch. 74-365; ss. 1, 2, ch. 75-33; s. 1, ch.

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76-166; s. 2, ch. 76-208; ss. 1, 2, ch. 76-250; s. 1, ch. 77-174; s. 1, ch. 77-231; ss. 1, 2, ch. 77-437; s. 2, ch. 78-95; s. 51, ch. 79-190; s. 1, ch. 79-205; s. 1, ch. 79-303; s. 1, ch. 79-412; ss. 1, 2, ch. 81-207; ss. 1, 2, ch. 83-307; s. 1, ch. 85-140; s. 1, ch. 87-407; s. 4, ch. 88-235; s. 12, ch. 89-291; s. 18, ch. 91-45; s. 1, ch. 94-139; s. 1403, ch. 95-147; s. 26, ch. 95-312; s. 5, ch. 96-310; s. 43, ch. 96-399; s. 23, ch. 98-136; s. 9, ch. 99-8; s. 7, ch. 99-155; s. 16, ch. 99-399; ss. 48, 53, ch. 2001-254; ss. 46, 79, ch. 2002-402; s. 2, ch. 2003-125; s. 123, ch. 2003-261; s. 49, ch. 2003-399; s. 5, ch. 2004-5; s. 32, ch. 2004-269.

¹Note.--

A. Section 32, ch. 2004-269, amended paragraphs (5)(c) and (6)(d) "[i]n order to implement sections 2 through 7 of the 2004-2005 General Appropriations Act." Portions of sections 2-7 were vetoed. See ch. 2004-268, the General Appropriations Act.

B. Section 75, ch. 2004-269, provides that "[a] section of this act that implements a specific appropriation or specifically identified proviso language in the 2004-2005 General Appropriations Act is void if the specific appropriation or specifically identified proviso language is vetoed. A section of this act that implements more than one specific appropriation or more than one portion of specifically identified proviso language in the 2004-2005 General Appropriations Act is void if all the specific appropriations or portions of specifically identified proviso language are vetoed." Not all portions of sections 2-7 were vetoed.

SECTION 3

**AASHTO UNIFORM
AUDIT & ACCOUNTING
GUIDE**

**Including FDOT
ANNOTATIONS**

For Audits of Transportation Consultants



UNIFORM AUDIT & ACCOUNTING GUIDE

September 2005

American Association of State Highway and Transportation Officials



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Printed in the United States of America

Uniform Audit and Accounting Guide

For Audits of Transportation Consultants' Indirect Cost Rates



Prepared by the American Association of State Highway
and Transportation Officials (AASHTO),
Audit Subcommittee

September 2005 Update

Assistance and consultation provided by:

Federal Highway Administration (FHWA) Resource Center, Atlanta, Georgia
and
American Council of Engineering Companies (ACEC) Transportation Committee

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Chapter

1

Chapter 1—Introduction, About This Guide

This guide has been developed by the American Association of State Highway and Transportation Officials (AASHTO) Audit Subcommittee with assistance from the American Council of Engineering Companies (ACEC) Transportation Committee and the Federal Highway Administration (FHWA) Atlanta Resource Center. The AASHTO Audit Subcommittee is comprised of the senior person representing the audit function for each state's transportation or highway department. This guide was developed over several years and initially approved by AASHTO at the organization's 2001 annual meeting and has been endorsed by the ACEC Transportation Committee. Input was solicited from all regions during 2004 for the 2005 update.

An electronic version of this guide can be found on the AASHTO home page:
<http://audit.transportation.org>

The purpose of the audit guide is to provide a tool that can be used by individual state auditors, consulting firms, and public accounting firms that perform audits of consulting firms. The primary focus of the guide is auditing and reporting on the indirect costs and resultant overhead rates of consultants who perform engineering and engineering-related work for State Highway Agencies.

This guide is not intended to be an auditing procedures manual but rather a guide that will assist individuals in understanding terminology, policies, audit techniques, and sources for regulations and specific procedures.

Note: Individual states may have specific limits and guidelines. Up-to-date contact information for all states can be found at the AASHTO web site.

Chapter

2

Chapter 2—Background

Most **State Highway Agencies (SHAs)** award contracts for engineering and related services using Qualifications Based Selection (QBS) procedures. Under QBS, consultant selections are based solely on elements of qualification without consideration of price. Consultants do not submit bids or priced proposals to be used as a basis for selection. Once the SHA has made a selection based on the consultant's qualifications, prices are negotiated based on the consultant's actual cost and must be a reasonable price for the work to be performed.

Federal law [23 USC Sec. 112 (b) (2) (C)] requires that contracts for engineering services be performed and audited in compliance with costs principles contained in the **Federal Acquisition Regulations (FARs)**. Because most SHAs construct highway improvements using both state and Federal funds, most have state rules for selection and pricing of state-funded consultant contracts that incorporate or are similar to Federal rules.

The timing and types of engagements performed to meet Federal requirements may vary between states and contracts depending on state procedures and other circumstances. The engagements are performed to ensure that consultant contract pricing is **based on actual costs incurred** in compliance with the Federal Acquisition Regulations as well as specific contract provisions.

Contract Engagements generally include the following:

INDIRECT COST RATES (COST INCURRED)

This engagement is performed to render an opinion on the consultant's indirect cost rate(s) for a specified period (usually a fiscal year). In addition to making sure that **unallowable** costs have been removed from overhead, the auditor must also make sure that **allowable** costs have been correctly measured and properly allocated. Established rates are used to retroactively adjust costs previously invoiced at provisional rates to actual cost. Many SHAs also use established indirect cost rates of the most recently completed fiscal year as a provisional rate to be used for estimating and invoicing costs on new **contracts**. Risk and materiality would be measured with consideration given to all contracts that may be priced using the indirect cost rate.

INDIRECT COST RATES (FORWARD PRICING)

This engagement is performed to render an opinion on the consultant's forward pricing indirect cost rate(s) used to prepare estimates of costs that will be incurred in future periods. Forward pricing rates are similar to cost incurred rates in that they have a **basis in historical costs**. However, forward pricing rates

Comment [FDOT1]: Audits performed by Certified Public Accountants for the purpose of establishing reimbursement rates to be applied in contracts with the Department are "Cost Incurred Audits." Historical cost information for the year most recently ended is used to establish reimbursement rates for indirect costs (overhead), direct expenses, and facilities capital cost of money to be applied to contracts entered in the next year. The Department applies the rates supported by historical costs as final, not provisional, rates.

are adjusted to reflect estimates of future costs and activity levels to project indirect cost rates for future periods. Auditors of forward pricing rates must evaluate the reasonableness of future projections as well as the accuracy of historical cost information used as the starting point for the rate development. While most contracts negotiated directly with the Federal government utilize forward pricing rates, **many SHAs will only negotiate contracts using indirect cost rates based on historical information.** Risk and materiality should be determined with consideration given to all contracts, which may be priced using the indirect cost rate

CONTRACT PRE-AWARDS

Contract pre-awards are performed to evaluate the reasonableness and accuracy of a cost proposal for a specific contract. The auditor may examine the reasonableness of estimates used as well as the accuracy of estimate components that are based on current or historical costs. When conducting pre-awards, auditors often rely on work done by other auditors. If other reports do not exist, auditors performing the pre-awards may examine items like indirect cost rates, schedules, accounting system surveys, and financial capability reviews. Risk and materiality should be determined with consideration only to the contract being covered by the pre-award. Auditors may be required to perform additional work for very large contracts.

CONTRACT COSTS

These engagements are performed to determine actual costs incurred under contracts. The auditor should consider both direct and indirect costs to determine whether costs invoiced were **allowable** under applicable cost principles and treated consistently with cost accounting practices used to develop the consultant's indirect cost rate(s). When conducting such engagements, auditors often rely on opinions rendered by indirect cost rate auditors. In addition to using the indirect cost rate, the auditor may be able to rely on evaluation and testing of accounting systems that were performed during indirect cost rate engagements. Risk and materiality should be determined with consideration only to the contract(s) being covered.

Comment [FDOT2]: All professional services contracts entered by the Department contain an "audit clause" making the contractor's records for the contract subject to audit at any time from award through a period ending three years following the contract closeout.

Auditing Standards

Auditing procedures and responsibilities may vary depending on the nature of the audit or attestation engagement procedures performed by the auditor. Several regulatory bodies may influence the types of procedures that will apply to planning, performing, and reporting on the results.

Government Auditing Standards ("Yellow Book")

These standards, published by the Comptroller General of the United States of America, apply to audits of government entities and government assistance paid to contractors, non-profit organizations, and other non-governmental organizations. They are often referred to as ***Generally Accepted Government Auditing Standards (GAGAS)***. The standards were revised and reissued in June 2003. Standards include the following:

- GAGAS may be used in conjunction with professional standards issued by other authoritative bodies. For example, the American Institute of Certified Public Accountants (AICPA) has issued professional standards that apply in financial audits and attestation engagements performed by certified public accountants (CPA). *GAGAS incorporate the AICPA's field work and reporting standards and the related statements on auditing standards for financial audits unless specifically excluded. GAGAS*

incorporate the AICPA's general standard criteria, and the field work and reporting standards and the related statements on the standards for attestation engagements, unless specifically excluded. GAGAS also prescribe requirements in addition to those provided by the AICPA to meet the needs of users of government audits and attestation engagements. Auditors may also consider other standards depending on the purpose and requirements of the audit or engagement.

GAGAS categorizes government audits and attestation engagements into three types for determining the appropriate standards. More than one type may apply to an audit engagement depending on the audit objectives.

- **Financial Audits** are primarily concerned with providing reasonable assurance about whether financial statements are presented fairly in all material respects in conformity with GAAP or with a comprehensive basis other than GAAP. An example would be an audit of a Schedule of Indirect Costs (considered a financial statement) in compliance with Part 31 of the Federal Acquisition Regulations. Financial audits may also include other objectives that provide different levels of assurance and entail various scopes of work.
- **Attestation Engagements** concern examining, reviewing, or performing agreed-upon procedures on a subject matter or an assertion about a subject matter and reporting on the results. These engagements may cover a broad range of financial or non-financial subjects and can be part of a financial audit or performance audit. Examples include an entity's internal control over financial reporting, an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants and various prospective financial statements or pro-forma financial information.
- **Performance Audits** entail an objective and systematic examination of evidence to provide an independent assessment of the performance and management of a program. These audits are generally performed to improve program operations and may encompass a wide variety of objectives. Examples include whether legislative, regulatory, or organizational goals are being achieved, the relative cost and benefits of a program and the validity and reliability of performance measures.

The following page provides a summary matrix of applicable standards for audits of Schedules of Indirect Costs.

Matrix of Generally Accepted Government Auditing Standards (GAGAS)

Note: The standards to be used vary depending on the type of audit or engagement. GAGAS standards generally include AICPA standards as well as additional GAGAS required standards. The following chart may be used as a guideline to determine the applicable standards. The Yellow Book should be consulted for the complete text of the standards.

Standard Category	Source	Financial Audit Standards	Examination Level Attestation Engagement Standards
General	AICPA	None	Evaluation Against Criteria
	GAGAS	Independence	Same as Financial
	GAGAS	Professional Judgment	Same as Financial
	GAGAS	Competence	Same as Financial
	GAGAS	Quality Control and Assurance	Same as Financial
Field Work	AICPA	Planned and Supervised	Same as Financial
	AICPA	Understand Internal Control	Similar to Financial
	AICPA	Evidential Matter	Sufficient Evidence for Conclusion
	GAGAS	Auditor Communication	Similar to Financial
	GAGAS	Results of Previous Audits	Same as Financial
	GAGAS	Detecting Material Misstatements	Similar to Financial
	GAGAS	Audit Documentation	Similar to Financial
Reporting	AICPA	GAAP or Not GAAP	None
	AICPA	Consistent Between Periods	None
	AICPA	Informative Disclosures	None
	AICPA	Opinion or Expression of Non-Opinion	None
	AICPA	None	Engagement Subject Matter
	AICPA	None	Practitioner's Conclusion
	AICPA	None	Practitioner's Reservations
	AICPA	None	Report Distribution Restrictions
	GAGAS	In Accordance with GAGAS	Same as Financial
	GAGAS	Internal Control Report	None
	GAGAS	Reporting Deficiencies	Same as Financial
	GAGAS	Responsible Officials Views	Same as Financial
	GAGAS	Privileged and Confidential Info	Same as Financial
	GAGAS	Report Distribution	Same as Financial

- The **Sarbanes-Oxley Act of 2002** was major legislation that affected publicly traded companies. It established the **Public Company Accounting Oversight Board (PCAOB)**, which has the authority to set auditing standards for registered public accounting firms involved with publicly traded companies. One key provision is the requirement that annual reports must include an internal control report from management along with an attestation report from the firm's auditor. These standards and the internal control reports may provide assurances when determining adequacy of controls for publicly traded consulting firms.
- Other audit standards and procedures may be considered depending on the circumstances (e.g., Institute of Internal Auditors, Federal Agencies, etc.).

Chapter

3

Chapter 3—Cost Principles

Federal Acquisition Regulations (FARs)

State Highway Agencies (SHAs) rely on the Federal Acquisition Regulations (FARs), Title 48, Chapter 1, Part 31—Contract Cost Principles and Procedures for guidance when negotiating costs and reviewing project proposals with consultants. The FARs contains cost principles and procedures for pricing contracts, subcontracts, and modifications to contracts. In addition, the FARs may also be used in the determination, negotiation, or allowance of costs when required by a contract clause.

The following is a general discussion of applicable cost principles described in Part 31 of the FARs. This discussion is on a summary level only and is not intended to be a complete rendition of all cost principles contained in the FARs.

The provisions apply to commercial organizations, educational institutions, state, local, and federally recognized Indian tribal governments and nonprofit organizations. Subpart 31.105, dealing with construction and architect-engineering contracts, states that the allowability of costs shall be determined in accordance with Subpart 31.2. For the purpose of our discussion, we will focus on Subpart 31.2—Contracts with Commercial Organizations.

The total cost of a contract includes all costs properly allocable to the contract under the specific contract provisions. The **allowable** costs to the government are limited to those costs which are **allowable** pursuant to Part 31.

In some cases, the contracting state may enter into an advance agreement with a consultant to clarify the allocability and allowability of special or unusual costs. Subpart 31.109 provides further clarification of advance agreements, including examples of costs for which advance agreements may be important.

In the absence of any advance agreements, the auditor must determine the allowability of costs. To determine the **allowability**, the auditor should consider the following:

1. Any limitations set forth in Subpart 31.2 of the FARs.
2. Allocability;
3. Standards promulgated by the Cost Accounting Standards Board (CAS); if applicable, otherwise, Generally Accepted Accounting Principles and practices appropriate to the particular circumstances;

Comment [FDOT3]: The Department utilizes the FARs and Florida Statute 112.061 in determinations of allowability of costs for overhead and direct expense listings in Reimbursement Rate Audit Reports. The FARs must be shown to be a basis of accounting practice used in preparing the audit report, F.S. 112.061 is no longer a required basis of accounting practice.

4. Terms of the contract; and
5. Reasonableness.

A cost is **reasonable** if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. The reasonableness of specific costs is not always easy to determine since such a determination depends to some extent on judgment and interpretation of the FARs.

Reasonableness depends upon a variety of considerations and circumstances, including the following:

1. Whether the cost is generally recognized as ordinary and necessary for the conduct of business or the contract performance;
2. Generally accepted sound business practices, arm's length bargaining, and Federal and state laws and regulations;
3. The consultant's responsibilities to the government, other customers, the owners of the business, employees, and the public at large; and
4. Any significant deviations from the firm's established practices.

A cost is **allocable** if it is assignable or chargeable to one or more cost objectives or cost centers on the basis of relative benefits received or some other equitable relationship. A cost must be distributed in some reasonable proportion to the benefits derived. A cost is allocable to a government contract if it:

1. Is incurred specifically for the contract;
2. Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
3. Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

Comment [FDOT4]: The allocation of certain indirect costs, such as fringe benefits, to direct objects is required for firms required to comply with Cost Accounting Standards (CAS). The numerical majority of firms seeking prequalification with the Department are not required to comply with CAS and should report fringe benefits as indirect costs in reports to the Department.

Costs that are expressly or mutually agreed to be **unallowable**, including directly associated costs, must be identified and excluded from any billing, claim, or proposal applicable to a government contract. A directly associated cost is any cost which is generated solely as a result of incurring another cost, and which would not have been incurred had the other cost not been incurred. When an **unallowable** cost is incurred, its directly associated costs are also **unallowable**. The practices to account for and present **unallowable** costs are described in 48 CFR 9904.405, Accounting for **Unallowable** Costs.

Comment [FDOT5]: All Department professional services contracts since October 1, 2003 have included the reimbursement of direct expenses through application of a Direct Expense Rate. The Direct Expense Rate will be based on a listing of qualified direct costs for the audit year presented in a Note to the indirect cost schedule or, if not included in the audit report, in a Supplemental Schedule submitted in addition to the audit report. Qualified direct expenses do not include subcontract costs, non-employee direct labor, or other "pass through" costs. Such costs will continue to be reimbursed based on invoiced actual costs, rather than as an element of the Direct Expense Rate.

In evaluating a consultant's overhead, an auditor must consider direct as well as indirect costs. A **direct cost** is any cost that can be identified specifically with a particular contract or project. Costs identified specifically with a contract or project are direct costs and are to be charged directly to the contract or project. All costs specifically identified with a project are direct costs of that project and cannot be charged to another project, either directly or indirectly. Finally, a cost cannot be charged as direct and also be included in any indirect cost pool. For reasons of practicality, small dollar direct cost items may

be treated as an indirect cost if the accounting treatment is consistently applied to all projects and produces substantially the same results as treating the cost as a direct cost. Variances and credits should then also be treated as indirect costs.

Indirect costs should be accumulated by **logical cost groupings** with due consideration of the reasons for incurring such costs. Commonly, manufacturing overhead, selling expenses, and general and administrative (G&A) expenses are separately grouped. The consultant's method of allocating overhead costs should be in accordance with generally accepted accounting principles, and are consistently applied.

Contracts may be subject to Cost Accounting Standards (CAS), which are promulgated by the Cost Accounting Standards Board (CASB), an independent board that reports to the Office of Federal Procurement Policy, within the OMB. All Federal contracts in excess of \$500,000 are subject to CAS regulations, unless specifically exempted.

A **distribution base** common to all cost objectives or projects is selected for allocation of an overhead or indirect cost pool. **Many consultants use direct labor as the base for developing overhead rates.** However, many large Federal contractors have rate structures that are more complex and utilize more than a single base for allocating costs. A typical example follows:

Comment [FDOT6]: The Department requires the use of a single, consistent direct labor base, declared for the Home Office and, if applicable, the Field Office. The declared direct labor bases are utilized as the computational base for each pair of indirect (overhead) and direct expense reimbursement rates accepted.

Cost Pool	Allocation Base
Employee Fringe Benefits	Direct Labor
Overhead Expenses	Direct Labor + Fringe
General & Administrative Expenses	Total Cost Input*

* In this scenario all costs are in the base for G&A expenses including direct labor, indirect labor, fringes, OH, unallowables, sub-consultants, etc.

Once a base or bases have been established, they should not be adjusted by removing individual components such as establishing individual segment rates, whose costs are already included in the overall rates. Rate structures and cost allocation methods must be consistent for all Federal and State government contracts. See Chapter 4 for additional information.

The **base period** for most consultants' overheads will normally be the firm's fiscal year, when a contract is performed over an extended period, as many base periods shall be used as are required to represent the period of contract **performance**. In certain instances an agreed upon rate may be used over the duration of the contract.

Comment [FDOT7]: The Department's overhead and direct expense rates must be renewed and recalculated annually, based on the Rate Audit report of an independent Certified Public Accountant. Multi-year contracts may provide for annual adjustment of applicable reimbursement rates, but need not. Contract cost reimbursement will always begin with the reimbursement rates applicable at the date of the agreement.

Chapter

4

Chapter 4—Cost Accounting

Allocation Bases

An allocation base is the means by which certain overhead or indirect costs are distributed to final cost objectives. There are a variety of allocation bases which are commonly used in cost accounting systems for allocating indirect costs, however, for State Highway Agency (SHA) administered engineering contracts **direct labor cost** is the most frequently used base. Whatever base is used for cost allocation, it should be consistent for all government contracts. Some of the common methods include:

Direct Labor Cost

Direct labor cost is the most common and accepted base used to allocate overhead costs on SHA contracts. Direct labor costs are generally all project hours multiplied by labor rates and summarized for all employees within the applicable allocation unit. Labor rates are based on actual employee wages paid or represent wages effectively paid.

Direct Labor Hours

The direct labor hour method is another way to allocate indirect costs based on total direct hours charged in an appropriate allocation unit.

Total Labor Hours (Total Hours Worked)

This method is similar to Direct Labor Hours allocation base, except that the base includes all hours incurred for direct and indirect activities. Use of this base assumes that costs incurred benefit both direct and indirect objectives and should be allocated to the appropriate pool receiving a benefit.

Total Costs

Generally, this is the base used to allocate G&A costs. The base consists of direct labor, fringe benefits, overhead costs, associated non-salary direct expenses (including other costs sometimes referred to as internal direct expenses), and subcontract costs.

Total Cost Value Added

This basis is similar to the Total Cost base shown above to allocate G&A costs. However, the value-added basis excludes materials (used primarily in production only) and subcontract costs. Distortion in

allocations may occur due to a disproportionate amount of subcontract costs or materials in the pool.

Usage

This method allocates costs to direct or indirect activities on a common unit, usually time or quantity used. For instance, an internal cost pool such as one for computer-aided drafting and design equipment (CADD) costs can be allocated specifically as a direct cost to a project or as an indirect cost based on the number of hours actually incurred.

Cost Centers

Cost centers are established to accumulate and segregate costs.

Functional Cost Centers

This method segregates costs unique to a business activity, typically for purposes of direct costing. Examples are CADD costs, vehicles, and reproduction services.

Subsidiaries, Affiliates, Divisions, and Geographic Locations

Another method is focused on the corporate structure. Some examples of cost centers used for accumulating costs are groupings of regional offices, specific subsidiaries, affiliates, divisions, or field offices.

Comment [FDOT8]: The Department accepts reimbursement rates for two "cost centers," generally corresponding to the work site from which individual workers contribute their direct labor:
*"Home Office" rates apply when the Consultant provides one or more central offices at which workers are predominantly located while performing the direct labor required to complete the contracted functions.
*"Field Office" rates apply when the Consultant staff are located in temporary field locations or in space provided by the Department, or other client, while performing the direct labor required to complete contracted functions.

Allocated Costs

Fringe Benefits

Fringe benefits are the costs associated with the business' portion of payroll taxes and benefits in employment. Such costs generally include, but are not limited to payroll taxes, pension plan contributions, medical insurance costs, life insurance, and employee welfare expenses.

Overhead

Overhead costs are costs that may benefit or are associated with two or more business activities, but are not specifically allocated to an activity for reasons of practicality. Overhead differs from general and administrative costs (below) in that these costs can be associated with a unit based on benefit. Some examples of overhead costs are rent, depreciation, employee recruitment and training, and general or professional insurance policy costs.

General & Administrative

This expense generally is all costs associated with the entire business' operation, which cannot be specifically identified with a smaller unit of business activities. Example, certain management or administration costs that are incurred for an entire business unit may be considered G&A, but other accounting or legal costs benefiting a segment of the business may be considered part of the overhead pool of that specific segment.

Comment [FDOT9]: The Department expects that all Overhead and General and Administrative Costs will be included in the single indirect cost report and allocation presented in Rate Audit reports for purposes of establishing acceptable overhead rates. The cost pools discussed below are, generally, no longer used by the Department to establish individual cost-based reimbursement rates. The costs accumulated in these pools may be included within the indirect cost pool or the direct cost pool, or partially in both, as determined appropriate by the Consultant and the CPA preparing the Rate Audit report.

Computer/CADD Costs

Generally, this pool includes costs such as equipment depreciation or rental; software including license costs; employee training costs on new software; equipment maintenance; cost of special facilities or locations; and systems development labor or support costs.

Fleet or Company Vehicles

For the most part, these costs are company vehicles such as cars, survey trucks, and vans that may be used for a direct or indirect cost objective. Pooled costs may include depreciation, lease costs, maintenance, insurance, and operation costs such as fuel.

Equipment

Costs accumulated to this pool are similar to both computer and company vehicle pools. Company equipment can be a wide variety of items from small to large that are used in various activities.

Printing/Copying/Plan Reproduction

Costs in this pool are generally associated with reproduction from a single page copied to multiple prints of large specialized drawings or blue prints. The pool in most cases includes equipment, labor, ink or toner, and paper supplies.

Direct Labor

Labor costs are usually the most significant costs incurred in the performance of government contracts. Incurred labor costs form the basis for estimating labor for future contracts. It is, therefore, imperative that consultants establish and maintain a sound system of internal control over the labor charging function.

Comment [FDOT10]: The Direct Labor cost reported for the Home Office and the Field Office in the Reimbursement Rate Audit Report, will be the computational base for determining both the Overhead rate and the Direct Expense rate to be utilized in contracts for the next year.

Unlike other items of cost, labor is not supported by external documentation or physical evidence to provide an independent check or balance. The key link in any sound labor charging system is the individual employee. It is critical to labor charging internal control systems that management fully indoctrinate employees on their independent responsibility for accurately recording time charges. This is the single most important feature management can emphasize in recognizing its responsibility to owners, creditors, and customers to guard against fraud, waste, and significant errors in the labor charging functions.

An adequate labor accounting system, manual or electronic, will create an audit trail whenever an employee creates a timesheet entry. A system that allows an audit trail to be destroyed is inadequate because the integrity of the system can be easily compromised. Access to timesheets should be controlled and preprinted, if possible, with the employee's name, number, and fiscal week. An inadequate system would allow employees to erase prior entries without recording the adjustment; adjustments should be maintained as part of the audit trail.

The consultant should have policies and procedures for training employees to reasonably assure that all employees are aware of the importance of proper time charging.

Uncompensated Overtime

Companies may not be required to pay overtime to salaried employees for hours worked in excess of 40 hours per week. Any hours worked by salaried employees in excess of the normal 40 hours per week are commonly called uncompensated overtime.

The consultant should have procedures to ensure that all hours worked are recorded, whether they are paid or not, to assure the proper distribution of labor costs. This is necessary because labor rates and labor overhead costs can be affected by total hours worked, not just paid hours worked.

Acceptable accounting methods for uncompensated overtime:

1. Compute a separate average labor rate for each pay period based on the salary paid and the total hours worked. Apply this rate to all cost objectives worked on during the period, including paid absences and indirect activities, to distribute the salary costs.
2. Determine a pro rata allocation of total hours worked during the period and distribute the salary cost using the pro rata allocation. If an employee worked 25 hours on one cost objective and 25 hours on another, each cost objective would be charged with one-half of the employee's salary.
3. Compute a standard hourly rate for each employee for the entire year based on the total hours the employee is expected to work during the year and distribute salary costs to all cost objectives worked on at the standard hourly rate. Any immaterial variance between actual salary costs and the amount distributed would be charged/credited to overhead. Material variances would be charged to the cost objective. Billings should be adjusted for material variances.

Any other methods would require further review to determine acceptability.

Some consultants' accounting systems may not assign costs to those hours worked by salaried employees in excess of 8 hours per day or 40 hours per week. Because there is a serious risk of mischarging costs to government contracts under these circumstances, the following methods of distributing these salary costs are **unacceptable**:

1. Distribute labor costs to only those cost objectives worked on during the first eight hours of the day.
2. Allow employees to select the cost objectives to be charged when more than eight hours per day are worked or the consultant has an informal policy as to how employees are to select the objectives to be charged.

Contracting state SHAs should be consulted to determine individual state interpretations where material amounts are involved.

Premium Overtime

Consultants should have the capability of maintaining records that segregate overtime premium amounts as direct or indirect costs. An acceptable method is to charge premium overtime as a direct charge when it is the consultant's regularly established policy and when appropriate tests

demonstrate that this policy results in equitable cost allocations. Premium overtime should be segregated as a direct cost whether reimbursable or not.

When employees normally work on multiple contracts it is often difficult to determine which contract “caused” the overtime. Therefore, many companies have a policy that overtime premium is allocated to overhead.

Comment [FDOT11]: Inclusion of overtime premium costs in either the direct expense listing, overhead listing, or, where the charging policy permits without duplication, both, are acceptable to the Department. The Department also allows a third accounting treatment for overtime premium costs; advance approval of overtime premium as a negotiated element of direct labor is permitted where the CPA Rate Audit Report specifically Notes these costs have not been included in either direct expenses or overhead, and are not reimbursed under either rate. See Section 1, Part IV C.4.b. of the Department's Guidelines.

Other Labor Considerations

The consultant should have procedures assuring that labor hours are accurately recorded and that any corrections to time keeping records are documented, including appropriate authorizations and approvals.

The consultant should have procedures requiring that the total labor dollars reflected in labor distribution summaries agree with the total labor charges as entered in the time-keeping and payroll systems. This reconciliation ensures the labor charges to contracts represent actual paid or accrued costs and that such costs are appropriately recorded in the accounting records.

The consultant should have procedures requiring that direct and indirect labor costs directly associated with **unallowable** costs are identified and segregated.

Areas of Potential Risk

- 1. Overrun Contracts.** When contract costs have exceeded or are projected to exceed contract value, these excess costs should not be diverted to other cost objectives such as indirect labor, overhead accounts, or other contracts.
- 2. Significant Increases in Direct/Indirect Labor Accounts.** Trend analyses may disclose instances where charges to direct or indirect labor accounts have increased significantly. Sufficient review should be performed to determine the nature of the increase.
- 3. Reorganization/Reclassification of Employees.** The organizational structure of the consultant should be analyzed to determine if it permits inconsistent treatment of similar labor. For example, a program manager should not charge direct on cost-type contracts and indirect on fixed-price/commercial contracts.
- 4. Adjusting Journal Entries/Exception Reports (Labor Transfers).** Adequate rationale and supporting documentation should be available for all significant labor transfers.
- 5. Budgetary Control.** Consultants may operate management systems that require strict adherence to budgetary controls. If the system is inflexible, labor charges may have a tendency to follow the identical route of the budgeted amounts. Rigid budgetary control systems can result in predetermined labor charges.
- 6. Mix of Contracts.** Costs should be identified and charged consistently in the accounting system regardless of type of contract.

Sole Proprietors' and Partners' Salaries

The compensation of owners or partners must be charged as direct labor when they are personally engaged in performing under contracts. Salaries must be determined by advance agreements or negotiation. Please refer to each individual state policy for more specific requirements regarding treatment of this compensation.

Contract Labor/Purchased Labor

In some cases, firms contract for services provided by engineers, technicians, etc. rather than hire individuals as employees. This is commonly referred to as "Contract or Purchased Labor." The accounting treatment varies, depending on the circumstances under which the purchased labor costs are incurred.

Two acceptable methods of accounting for this labor are:

- Charged as a direct cost to projects, or
- Treated as other labor (direct or indirect as appropriate)

CAS 418 requires that pooled costs be allocated to cost objectives in reasonable proportion to the causal or beneficial relationship of the pooled costs to cost objectives. Purchased labor must share in an allocation of indirect expenses where such a relationship exists and the allocation method must be consistent with the consultant's disclosed accounting practices. A separate allocation base for purchased labor may be necessary to allocate significant costs to purchased labor, such as supervision and occupancy costs, or to eliminate other costs, such as fringe benefits, that do not benefit purchased labor.

Other Direct Costs—Outside Vendors/Employee Expense Reports

Other direct costs typically include subcontracts, travel, long-distance phone calls, and outside printing. Costs based on charge-out rates developed by the company, typically mileage and copying, are addressed elsewhere. In order to be treated as a direct cost, the item must have been needed for and used on that job, the "but-for" principle. But for this job, the cost would not have been incurred. All similar costs must also be treated as direct costs.

Field Office Rates

Field offices may exist in several forms. Regardless of the consultant's organization, consistency in allocating costs to cost objectives is critical.

A consultant's employees may work for a period of time in an on-site office maintained by the SHA. Since the consultant's employees are not working out of their own offices and are not receiving office support in their day-to-day activities, the hours billed for them do not qualify for the consultant's full overhead rate.

Comment [FDOT12]: Where "Purchased Labor" is employed to provide direct labor services which otherwise would have been provided by employees, the costs incurred for substitute direct labor may not be listed as a qualified direct expense in Rate Audit reports. In contracts with the Department, such costs will be reimbursed as direct labor or as subcontracts. Similarly, the costs of pre-approved subcontracts, referred to below, will be reimbursed on the basis of invoiced actual costs passed through the prime contractor and, therefore, may not be listed as a qualified direct expense.

Comment [FDOT13]: The Department recognizes three categories of direct costs: direct labor, including employees and non-employees fulfilling the contractor's man-hour commitments; pass through costs, such as subcontracts and extraordinary items; and other direct costs, to be reported and reimbursed through the Direct Expenses reimbursement rate.

The purpose of the field rate is to pay the consultant for the fringe benefits and home office support they do provide to their field employees.

Approved costs directly identified with the project and consistently treated as direct costs in the consultant's accounting records will be allowed as direct project costs.

Field Office Indirect Costs

As a general rule, SHAs do not require extensive staffing of consultants' field offices. Most administrative and management functions will be performed in the home or branch office. Therefore, an equitable portion of these offices' indirect costs should be allocated to the field office. The costs that are allocated, and the basis for the allocation, depend largely on the consultant's customary accounting practices. Some SHAs require separate cost centers for accumulation of field office costs.

Comment [FDOT14]: The Department requires that direct labor performed in a Field Office location, including where space is provided in a FDOT District Office, be segregated from direct labor performed in the Home Office. All direct charges incurred in the performance of the associated contract should be traceable to and reported for the contract's "location." Indirect costs are allocable as described below.

Fringe Benefits: The fringe benefits applicable to the field office direct labor costs should be allocated to the field office overhead pool. If the consultant's accounting records do not maintain separate accounts for field office fringe benefits, the fringe benefits should be allocated on a direct labor basis:

$$\frac{\text{Field Direct Labor}}{\text{Total Direct Labor}} = \text{Field Office Direct Labor \%}$$

Indirect Labor—Non-Project Time: Labor costs pertaining to non project time of professional staff is generally recorded specifically within the Field or Home Office accounts. If these costs are not segregated a ratio based on the Field Office Direct Labor percentage may be used to allocate costs to the Field Offices.

Indirect Labor—Support Staff: Indirect salaries (accounting, legal, purchasing, personnel, management, etc.) should also be allocated to the field office overhead pool. A ratio of total Field Office labor to Total Company Labor would be a reasonable method to allocate these costs. Some firms allocate the costs on a direct labor basis.

Indirect Expenses

Certain field office related costs should be allocated 100 percent to the field office pool (e.g., field equipment, on-site trailer rental for multiple projects, field supplies, etc.).

Other general indirect expenses are allocated to the field office overhead pool based on a reasonable estimate of the benefits accruing to the field office pool. One possible method is to compute a percentage based on the field office total labor compared to the total company labor:

$$\frac{\text{Field Labor (Direct plus Indirect)}}{\text{Total Company Labor (Direct plus Indirect)}} = \text{Field Office Labor \%}$$

The resulting percentage is applied to the various general expense line item accounts identified in a firm's overhead schedule.

Note: The firm must disclose the existence of Field Office Rates in the Schedule of Indirect Costs. A separate column showing the Field Office expenses, direct labor and resulting rate along with footnote disclosure describing allocation methods used should be provided. An example of a Schedule of Indirect Costs including a Field Office rate is included in Chapter 9.

Chapter

5

Chapter 5—Selected Items of Cost

The purpose of this chapter is to provide guidance for **selected items of cost**. It is organized by FAR Part 31.2 sub-sections in ascending order, numerically. It is not meant to be authoritative or to supersede the FARs. The items in this chapter have been reviewed and updated as of March 2005, although the FAR is continuously revised. The entire text of the FARs should be consulted when determining proper accounting treatment (see Chapter 12 for sources). A listing of Common Unallowable Expenses, to be used as a quick reference, is included at the end of this chapter.

Advertising and Public Relations (FAR 31.205-1)

Advertising Costs

Selected **allowable** advertising costs include:

- recruiting personnel required for performing contractual obligations;
- costs of activities to promote sales of products normally sold to the U.S. government, including trade shows, which contain a significant effort to promote exports from the United States, or
- employee recruitment costs in accordance with FAR 31.205-34.

Even those advertising costs that are **allowable** must be reasonable, allocable, and properly assigned to cost objectives.

Allowable advertising can recruit direct as well as indirect labor. Costs of recruiting employees with skills needed only for commercial contracts are **unallowable**, however. Costs are considered **unallowable** when no specific vacancies are to be filled or if the advertising done is out of proportion to the number or importance of the positions to be filled.

Trade Show Expenses and Labor

Expenses and labor pertaining to trade shows and other special events are generally **unallowable** except as described above under advertising costs to promote export sales.

Public Relations Costs

Public relations include functions and activities dedicated to enhancing an organization's image or

products and maintaining or promoting favorable relations with the public.

Specifically, costs of promotional material, motion pictures, videotapes, brochures, handouts, and magazines that are designed to elicit favorable attention to the contractor are **unallowable** unless used primarily for employee training and orientation. Costs of memberships in civic and community organizations and costs of souvenirs, models, imprinted clothing, buttons, and other mementos provided to customers or the public are also **unallowable**.

Allowable public relations costs include costs incurred for (a) responding to inquiries on company policies and activities; (b) communicating with the public, press, stockholders, creditors, and customers; and (c) conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary to keep the public informed on matters of public concern such as notice of contract awards, plant closings or openings, employee layoffs or rehires, and financial information.

Comment [FDOT15]: : (FAR 31.205-1(e)(3)) The costs of participation in community service activities, commonly limited to the personnel costs, may also be allowable public relations costs. See also FAR 31.205-8.

Bad Debts and Collection (FAR 31.205-3)

Bad debts, including actual or estimated losses arising from uncollectible accounts receivable due from customers and other claims, and any directly associated costs such as collection and legal costs are **unallowable**.

Compensation (FAR 31.205-6)

Reasonableness (refer to FAR 31.201-3 and 31.205-6(b))

Costs must be reasonable in amount considering what is normal for a comparable business, the established compensation plan or practice of a given contractor, or restraints imposed by business circumstances.

Auditors can challenge either the reasonableness of individual components of employee compensation or the reasonableness of total compensation costs.

Bonuses and Incentive Compensation (FAR 31.205-6(f))

The following types of bonuses and incentive compensation are usually **allowable**: incentive compensation for management employees, cash bonuses, suggestion awards, safety awards, and incentive compensation based on production, cost reduction, or efficient performance. To be **allowable**, bonus or incentive compensation must be:

1. granted under an agreement entered into in good faith between the employer and the employee, before the services are rendered; **or**
2. granted pursuant to an established plan or policy followed consistently (to the point of implying an agreement).

Auditors may challenge bonus plans that are not based strictly on production, cost reduction, or efficient performance.

Bonuses and other forms of compensation for owners of closely held companies should be reviewed

carefully to ensure they are not dividends that would be considered distribution of profits. **Distributions of profits** are **unallowable** for inclusion in either direct or indirect labor costs.

Compensation Limits (Executive Compensation Benchmarks) (FAR 31.205-6(p))

Compensation limitations involve numerous factors including size of firms, type of industry, geographic area, classes of employees doing similar work, type of ownership, form of compensation payments, and other factors. Auditors must review a wide range of company information and review outside sources in order to determine reasonable compensation.

In addition to reasonableness, executive compensation for government contractors is specifically limited by part 31.205-6(p) of the FARs. This section of the FAR must be referenced in order to apply the limits for senior executives.

Benchmarks are established annually by the Office of Federal Procurement Policy (OFPP), which is under the Office of Management and Budget (OMB). The Office of Management and Budget Administrator, pursuant to Section 808 of Public Law 105-85, determines the limits, which are based on salaries of executives of publicly owned corporations that have annual sales of over \$50 million. The term compensation includes wages, salary, bonuses, deferred compensation, and employer contributions to defined pension plans. The cost rule is applied to the senior executives at corporate offices and business segments.

Maximum limits for contract costs incurred after the following effective dates are as follows: (The amounts can be obtained annually from the OMB web site)

Maximum Compensation Limits

July 1, 1996	\$200,000
January 1, 1997	\$250,000
January 1, 1998	\$340,650
January 1, 1999	\$342,986
January 1, 2000	\$353,010
January 1, 2001	\$374,228
January 1, 2002	\$387,783
January 1, 2003	\$405,273
January 1, 2004	\$432,851
January 1, 2005	\$473,318

Pension Plans (FAR 31.205-6(j))

Pension plan expenses are complicated so that FARs, IRS regulations and CAS regulations must be carefully reviewed in order to determine allowability of costs. Generally, a pension plan is a deferred compensation plan that provides for systematic payment of benefits that are paid for life, or gives employees the option for benefit payments for life. **Qualified pension plans** are definite written programs that meet the criteria as set forth by the Internal Revenue Code. All other pension plans are considered **unqualified pension plans**. Costs for either type of plans may be allowable depending on the specific circumstances.

Comment [FDOT16]: The Department has established a limit on the Department's participation in bonus and incentive compensation to individuals owning or controlling a 5% interest in the firm. Bonuses that exceed 15% of the individual's base compensation, reported as direct or indirect labor, for the audit period are considered capital costs, not reasonable operating costs of the business.

Comment [FDOT17]: Although executive compensation is limited at the Federally established amount, this compensation test is separate from the "reasonableness" test. There exists NO presumption that compensation below the maximum limit is reasonable; this judgment must be made based on the factors listed in the first paragraph.

Comment [FDOT18]: Please notice that total compensation includes bonuses, deferred compensation, and employer contributions to retirement plans, including 401(k) contributions, in addition to cash compensation reported as direct or indirect labor.

One of the critical FARs requirements is that, for pension costs to be **allowable** in the current year, they must be funded by the due date for filing the Federal income tax return. Pension costs assigned to the current year but not funded on time are **unallowable** in any subsequent year.

The amount contributed to qualified pension or profit sharing plans on behalf of principals and employees is **allowable**. However, the payments must be reasonable in amount and be paid pursuant to an agreement entered into in good faith between the contractor and employees, before the work or services are performed and pursuant to the terms and conditions of the established plan.

Costs of changes that are discriminatory to the government or that are not intended to be applied consistently in the future are **unallowable**. One-time-only pension supplements not available to all plan participants are generally **unallowable**, unless the supplemental benefits represent a separate pension plan and the benefits are payable for life at the employee's option. Increased payments to retired participants for cost-of-living adjustments are **allowable** if paid in accordance with a consistent policy or practice.

Employee Stock Ownership Plans (FAR 31.205-6(q))

Employee stock ownership plans (ESOPs) are an individual stock bonus plan designed specifically to invest in the stock of the employer corporation. These complex plans have become more prevalent in recent years. The contractor's contributions to an employee stock ownership trust (ESOT) can be in the form of cash, stock, or property.

The purpose of an ESOP may be for deferred compensation or for a supplementary pension plan; each would be covered by different regulations. In order to determine whether certain ESOP costs are allowable, FAR 31.205-6(q) should be referenced along with Cost Accounting Regulations 48 CFR 9904.412 and .415.

Valuations for ESOPs must be done on a case-by-case basis and certain contributions in excess of fair market value are **unallowable**.

Severance Pay (FAR 31.205-6(g))

Severance pay or dismissal wages are extra payments made to employees whose employment is involuntarily terminated. Severance pay does not include payments under early-retirement incentive plans.

Severance pay is **allowable** only when payment is required by (1) law, (2) employer-employee agreement, (3) established policy that is, in effect, an implied agreement on the contractor's part, or (4) circumstance of the particular employment. Normal severance pay relates to recurring, partial layoffs, cutbacks, and involuntary separations and is an **allowable** cost when properly allocated.

"Normal severance" refers to routine employee terminations. **"Abnormal severance"** refers to any mass termination of employees, which is usually unpredictable. Actual costs of normal severance pay must be allocated to all work performed at the contractor's facility. Accruals of normal severance pay are acceptable (1) if the amount is reasonable in light of prior experience, and (2) if it is allocated to both government and non-government work. Abnormal severance, however, is **unallowable** as an accrued cost because of the conjectural nature of the cost.

Special compensation to terminated employees after a change in management control is **unallowable** to the extent that it exceeds normal severance pay (“golden parachute”). Special compensation contingent on the employee remaining with the organization after a change in management control is also **unallowable** (“golden handcuff”).

Personal Use of Company Vehicles (FAR 31.205-6(m)(2))

This cost is **unallowable**, including the portion of cost related to transportation to and from **work**.

Comment [FDOT19]: (FAR 31.205-6(m)) Personal use of a company vehicle is unallowable regardless of whether the cost is reported as taxable income to the employees.

Contributions or Donations (FAR 31.205-8)

Contributions in the form of cash, property, and services are **unallowable** except for costs of participation in community services such as blood bank drives, charity drives, disaster assistance, etc..

Cost of Money (FAR 31.205-10)

This is an imputed cost related to investment in facilities used in contract performance whether the source of the investment is equity or borrowed capital. The resulting cost of money is not a form of interest on borrowing.

The costs of the capital investment must be determined, measured, and allocated to contracts in accordance with CAS 414.

The estimated facilities capital cost of money **must** be specifically identified in the cost proposals relating to the contract under which the cost is to be **claimed**.

Comment [FDOT20]: The Department has established a Facilities Capital Cost of Money rate (FCCM), a separate reimbursement rate based on the average net book value of capital assets reported in the Rate Audit report. The FCCM rate is a firm-wide rate based on total direct labor and is applied to all Department contracts.

Accounting for the facilities cost of money is generally through a memorandum entry of the cost. The contractor must maintain, in a manner that permits audit and verification, all relevant schedules, cost data, and other data necessary to support the entry fully.

The cost of money rate (**prompt payment rate**) is the arithmetic mean of the interest rates specified by the Secretary of the Treasury. These are published in the Federal Register around January 1 and July 1. For a fiscal year ending December 31, the arithmetic mean would be the simple average of the rates for the January 1 through June 30 period and the July 1 through December 31 period.

The average book value of the investment base is multiplied by the cost of money rate. The resultant value is divided by the allocation base units (such as direct labor hours, or dollars of total cost input) for the corresponding indirect cost pool.

Appendix A to CAS 414 contains the form for Facilities Capital Cost of Money and Appendix B to CAS 414 contains a detailed example in which the total cost of money on facilities capital is computed on a step-by-step basis.

Depreciation (FAR 31.205-11)

In general, depreciation of plant, equipment and other capital assets is allowable if it does not exceed the amount used for financial reporting purposes. Depreciation is generally based on the useful business life of the asset and should not be based on accelerated depreciation methods that may be acceptable for IRS tax **purposes**. Special consideration must be given to consistency between organizations under common

Comment [FDOT21]: Equipment write-offs (expensing) allowable under Section 179 of the Internal Revenue Code are not allowable in Rate Audit reports.

control, fully depreciated assets, asset disposals, capital leases, rentals, and other special CAS provisions contained in the FAR.

Employee Morale, Health, and Welfare (FAR 31.205-13)

Employee welfare and morale expenses incurred on activities to improve working conditions, employer–employee relations, employee morale, and employee performance are **allowable**. Expenses and income generated by employee welfare and morale activities should be in compliance with FARs 31.205-13. Note that employee morale type expenses are often covered by the entertainment cost principle, 31.205-14. FAC 90-31, effective October 1, 1995 clarified that entertainment costs are **unallowable** under any cost principle, without exception. Consequently, the entertainment cost principle at FARs 31.205-14 takes precedence over any other cost principle.

Although gifts are an expressly **unallowable** expense, the cost principle **specifically excludes two categories** of awards from the **unallowable** gift definition:

1. Awards covered by the compensation cost principle FAR 31.205-6; and
2. Awards made pursuant to an established plan or policy for recognition of employee achievements.

Recreation expenses are an expressly **unallowable** expense unless the cost claimed meets the following criteria:

1. The cost is for employee participation in a sports team or employee organization.
2. The team or organization is company sponsored.
3. The team's or organization's activity is designed to improve company loyalty, team work, or physical fitness.

Costs incurred for employee welfare and morale, less credits for income generated by these activities, are **allowable** to the extent that the net amount is reasonable. Reasonableness is considered in nature and amount both for the contractor as a whole and for the employee(s) benefited by the expenditure.

Whether or not the IRS has recognized certain costs as deductible business expenses for Federal income tax purposes is not necessarily determinative of their allowability under government cost-reimbursement type contracts where such costs fail to satisfy allowability or reasonableness criteria.

Types of activities that fall under this subsection are very restrictive and limited. Examples of **allowable** activities are house publications, health clinics, wellness/fitness, employee counseling services, and food and dormitory services.

Entertainment (FAR 31.205-14)

Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are **unallowable**. Costs of membership in social, dining, country clubs, or other organizations having the same purposes are also **unallowable**, regardless of whether the cost is reported as taxable income to the employees.

Fines and Penalties (FAR 31.205-15)

Costs of fines and penalties resulting from violations of, or noncompliance with, Federal, state, local, or foreign laws and regulations, are **unallowable** except when incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer.

Bid and Proposal (FAR 31.205-18)

The composition of bid and proposal costs is often a key issue. Although marketing costs are very similar to bid and proposal costs, basic bid and proposal costs are incurred in preparing specific documents, whereas selling and marketing costs are more general in nature. Therefore, a contractor should establish procedures for segregating bid and proposal costs from selling and marketing costs.

Bid and proposal costs are **allowable** and should be treated as indirect costs unless the contract requires submission of a proposal for subsequent work and authorizes the costs to be charged directly to that contract.

Pre-contract costs are those costs that are considered as part of the **direct costs** of the contract, but are incurred prior to execution of the contract. These costs are **unallowable** as indirect costs.

Insurance, Key-Man Life, and Re-Work (FAR 31.205-19)

“Key-man life insurance” is individual insurance, (not group insurance for all employees), on the lives of officers, partners, proprietors, or employees who are considered critical to the operations of the company. The company is named as the beneficiary and each person insured is evaluated based on his/her age, health history, and value to the company. The premiums are considered an **unallowable** expense unless the insurance is included as additional compensation to the employee, and the employee’s family is listed as beneficiary.

“Re-work insurance” is not a term used in the FAR. Insurance industry terminology is generally “Professional Liability” or “Errors and Omissions,” which is a type of casualty insurance. FAR 31.205-10(e)(3) contains the following provision:

“The cost of insurance to protect the contractor against the costs of correcting its own defects in materials and workmanship is **unallowable**. However, insurance costs to cover fortuitous or casualty losses resulting from defects in materials or workmanship are **allowable** as a normal business expense.”

Interest Costs (FAR 31.205-20)

Interest on borrowings (however **represented**), bond discounts, costs of financing and refinancing capital (net worth plus long-term liabilities), legal and professional fees paid in connection with preparing prospectuses, costs of preparing and issuing stock rights, and directly associated costs are **unallowable** except for interest assessed by state or local taxing authorities under the conditions specified in 31.205-41.

Comment [FDOT22]: The costs of securing and utilizing credit, including credit card fees, interest, and financing charges, are borrowings or associated costs.

Lobbying Costs (FAR 31.205-22)

Lobbying and political activity costs are generally **unallowable**. Some examples of these types of costs are activities that attempt to influence the outcomes of Federal, state, or local elections, contribute to political

parties or organizations, influence Federal, state, or local legislation, influence legislative liaison activities or influence employees of the executive branch of government. Certain activities **may be allowable** if detailed records are maintained. They may include activities such as testifying at hearings, providing technical information on topics directly related to contracts, or lobbying activities that may directly reduce contract cost.

Comment [FDOT23]: Contributions or payments to Professional Organizations, Trade Groups, or Industry groups for the purpose of use in lobbying by the second party are, similarly, unallowable.

Losses on Other Contracts (FAR 31.205-23)

Any excess of costs over income under any other contract (including the contractor's contributed portion under cost-sharing contracts) is **unallowable**.

Organization and Reorganization (FAR 31.205-27)

All expenditures in connection with planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, or raising capital are **unallowable**. The exception to this is under (b), the cost of activities primarily intended to provide compensation. These costs will not be considered organizational costs but are governed by FAR 31.205-6.

The rationale for disallowing these costs is that the government entered into a contract with a specific entity considered competent to perform the work and should not reimburse the costs of corporate changes not incident to contract performance.

Patent Costs (FAR 31.205-30)

Patent costs not required by the government contract are **unallowable**.

Certain costs **may be allowable** if they are incurred as a requirement of a government contract. They include costs such as preparing disclosures, filing documentation, searching records, and counseling related to general patent matters.

Retainer Agreements (FAR 31.205-33)

Work performed by professionals and consultants with special skills are **allowable** but must be supported by detailed evidence of the nature and scope of the work performed. However, retainer agreements which are not based on specific statements of work performed are **unallowable**.

Relocation Costs (FAR 31.205-35)

Certain costs of relocating permanent employees are **allowable** if numerous requirements are met. **Some examples** of the conditions which would cause the costs to be **unallowable** are:

- mortgage-related costs if employees were not homeowners prior to the move
- if the move was for a period of time less than 12 months
- the move does not benefit the employer
- employer does not have a consistent relocation policy for all employees
- costs represent loss on sale of a home

- continuing mortgage principal payments on sold residence

Rent/Lease (FAR 31.205-36)

The most common form of renting or leasing real or personal property is via an **operating lease** where the consultant pays rent to a third party at prevailing market rates. These costs are generally **allowable**.

However, in some cases, property is considered a “purchased asset” and must be accounted for as a **capital lease**. In the case of a capital lease the capitalized value of the assets must be distributed over its useful life as depreciation charges or over the term of the lease as amortization charges. Criteria were established by FAS-13 in paragraph .007, which classifies leases. If a lease meets one or more of the following four criteria, the lease shall be classified as a **capital lease**. Otherwise, it shall be classified as an **operating lease**.

1. The lease transfers ownership of the property to the lessee by the end of the lease term.
2. The lease contains a bargain purchase option.
3. The lease is equal to 75 percent or more of the estimated economic life of the leased property.
4. The present value at the beginning of the lease term of the minimum lease payment (with certain exclusions) equals or exceeds 90 percent of the fair value of the leased property to the lessor at the inception of the lease over any related investment tax credit retained by the lessor and expected to be realized by him.

Common control is another important issue when considering the allowability of rental costs. Charges in the nature of rent for property between any divisions, subsidiaries, or organizations under common control, are **allowable** to the extent that they **do not exceed the normal costs of ownership**, such as depreciation, taxes, insurance, facilities capital cost of money, and maintenance, provided that no part of such costs shall duplicate any other allowed cost.

Comment [FDOT24]: The costs of ownership, not the fair retail value of the space, is the determining factor in related party rental arrangements.

Selling Costs (FAR 31.205-38)

Selling costs are **allowable** if reasonable.

Selling and marketing costs cannot be adequately identified by mere reference to account titles. Such a shallow analysis is not sufficient to assess the allocability and allowability of costs within an account. The actual composition of the account or the activities it represents must be known and analyzed.

Any selling and marketing costs are subject to government challenge if the costs can be considered unnecessary for government contracts. In determining the reasonableness of selling costs, the government considers the nature and amount of the expense in light of the expenses that a prudent individual would incur in a competitive business, the proportionate amounts expended as between government and commercial business, the trend and comparability of current costs with historical costs, the general level of selling costs in the industry, and the nature and extent of the selling and marketing efforts in relation to the contract value.

Some states have more specific policies regarding selling costs and state that “general sales promotion” costs shall include/encompass any activity conducted by a company that is meant to call attention to or

enhance the image of the company, its products and/or services. Any cost associated with such activity shall be **unallowable**.

Travel Expenses (FAR 31.205.46)

Travel expenses, based on their nature and purpose may be **allowable** as either indirect or direct. Travel costs incurred in the normal course of overall administration of the business are **allowable** and shall be treated as indirect costs. Travel costs attributable to specific contract performance are **allowable** and may be charged to the contract. Costs for transportation may be based on mileage rates, actual costs incurred, or on a combination thereof; costs of lodging, meals, and incidental expenses may be based on per diem, actual expenses, or a combination thereof, provided the method used results in a reasonable charge as provided in the **Federal Travel Regulation (FTR)**. Individual state contract limits may be more restrictive.

Comment [FDOT25]: See Section 2 of the Department's Reimbursement Rate Audit Guidelines, 2005, for a discussion of Florida Statute 112.061. Cost limitations and constraints contained in F.S. 112.061 are currently more restrictive than limits set forth in the Federal Travel Regulations. The limitations of F.S. 112.061 are applicable to all contracts entered by the Department and, therefore, to all direct and indirect costs reported in Rate Audit reports used to establish reimbursement rates. FAR compliant audit reports of indirect costs are not required to limit allowable costs based on the Florida Statute.

Costs shall be **allowable** only if the following information is documented:

- Date and place
- Purpose of trip
- Name of personnel or relationship to the company
- For transportation costs a log must be maintained

Legal Costs (FAR 31-205-47)

Costs incurred in connection with any proceeding brought by a Federal, state or local government for violation by the consultant of a law or regulation are often **unallowable**. The FARs provide specific criteria. Costs of legal, accounting, etc. that arise as a result of a dispute between consultants that are partners in a joint venture, or similar shared interest arrangement, are **unallowable**. This FARs section also requires that these costs, including directly associated costs, which may be unallowable, be segregated in the accounting system.

Legal costs pertaining to organization or reorganization activities are **unallowable**.

In certain situations, significant legal costs may be incurred in one or more accounting periods and recoveries from settlements may be received in subsequent periods. A portion of the recoveries should be credited to the accounts where the legal costs were incurred.

Business Combination Costs (FAR 31.205-49 and -52)

A business combination occurs when a corporation and one or more incorporated or unincorporated businesses are brought together into one accounting entity. These combinations are classified as mergers or consolidations and are accounted for as purchases or pooling of interests. The purchase method accounts for a business combination as the acquisition of one company by another (merger). Any difference between the cost of an acquired company and the sum of the fair values of tangible and identifiable intangible assets less liabilities is recorded as goodwill.

Costs for amortization, expensing, write-off, or write-down of goodwill (however represented) are **unallowable**.

When the purchase method is used, **allowable** costs for amortization, cost of money, and depreciation are limited to the amounts that would have been allowed had the combination not taken place. Consultants must maintain detailed records which identify and track elements of costs for future reporting periods.

Alcoholic Beverages (FAR 31-205-51)

Costs of alcoholic beverages are **unallowable** and consultant's records should clearly segregate these costs and exclude them from the indirect cost schedule. These costs should also not be included in direct contract cost invoices.

Listing of Common Unallowable Expenses

The following table provides a listing of expenses that are generally not allowed (under provisions of the Federal Acquisition Regulations, part 31.2) by commercial enterprises performing contracts for the government. The list identifies transactions that are commonly incurred by consulting engineering firms, but is not all inclusive.

FAR Reference	Unallowable Expenses
31.205-1	Advertising
31.205-1	Trade Show Expenses
31.205-1	Trade Show Labor
31.205-1	Promotional Material/Brochures
31.205-1	Souvenirs/Imprinted Clothing Provided to Public
31.205-1	Membership in Civic and Community Organizations
31.205-3	Bad Debts
31.205-3	Collection Costs
31.205-6	Personal Use of Company Vehicles
31.205-8	Contributions or Donations
31.205-13	Employee Gifts and Recreation
31.205-14	Membership in Social/Dining/Country Clubs
31.205-14	Social Activities
31.205-15	Fines/Penalties
31.205-19	Key-Man Life Insurance (unless considered compensation)
31.205-19	Re-Work Insurance (errors and omissions)
31.205-20	Interest Expense
31.205-22	Lobbying Costs
31.205-27	Organization/Re-Organization Legal Fees
31.205-27	Organization/Re-Organization Accounting Fees
31.205-27	Organization/Re-Organization Incorporation Fees
31.205-27	Organization/Re-Organization Labor
31.205-27	Capital Raising (Equity or LT Debt) Legal Fees
31.205-27	Capital Raising (Equity or LT Debt) Accounting Fees
31.205-27	Capital Raising (Equity or LT Debt) Lender Fees
31.205-30	Patent Costs
31.205-33	Retainer agreements
31.205-35	Relocation Costs (in certain circumstances)
31.205-46	Travel Costs in Excess of FTR Rates
31.205-49	Goodwill
31.205-51	Alcoholic Beverages

Chapter

6

Chapter 6—Management’s Responsibility for Accounting Records

It is the responsibility of management of companies involved in government contracts to prepare timely, accurate financial information. In most cases special schedules and disclosures will be required in addition to normal annual financial statements, prepared for stockholders, for lending institutions or for internal management.

It is the responsibility of management to require CPAs to provide access to working papers to Federal or state agency auditors.

Schedule of Indirect Cost

The Schedule of Indirect Cost is the primary document for presenting the overhead rate. It will be developed from financial statement and/or general ledger amounts as well as from amounts in the company’s cost accounting system. This schedule must be in agreement with or reconciled to financial statement and/or general ledger amounts.

The schedule should clearly display the **unallowable** amounts that have been removed from the indirect expense accounts. If the schedule is presented “net of **unallowable** costs,” a description of the **unallowable** costs must be disclosed in the accompanying notes.

Direct labor should be included as a separate line item and must be in agreement with general ledger and/or project accounting records.

Other items, such as Facilities Capital Cost of Money, may be shown as required by individual states.

The Schedule of Indirect Costs or accompanying notes should show the calculation of the overhead rate. In some cases multiple overhead rates will be shown such as functional rates for segments of the business, or rates for separate subsidiaries.

When a company uses Field Office (Onsite) rates in addition to Home Office (Offsite) rates, costs and labor amounts for both rates should be displayed on the Schedule of Indirect Costs. The rate structure and allocation methodology should be clearly explained in the footnotes.

It should be emphasized the consultant is responsible for accounting for costs appropriately and for

Comment [FDOT26]: The Department prefers to title the indirect cost schedule “Statement of Direct Labor, Fringe Benefits, and General Overhead.” We believe this title places a proper emphasis on the declaration of the direct labor base to be used in establishing rates for the year. However designated, the Statement must contain a listing of the direct labor base for each “Office,” a detailed listing of fringe benefit costs, and a listing of all other indirect costs.

Comment [FDOT27]: The Department strongly prefers both a display of unallowable amounts and a reference to the reason for disallowance.

Comment [FDOT28]: FCCM is accepted as a separate rate by the Department. FCCM may be shown on the same sheet with the indirect cost schedule, but should not be included in the listed indirect costs for purposes of calculating the overhead rate.

maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles. Examples of supporting documentation include time sheets and usage logs. Costs which are not adequately supported may be disallowed all or in part by the auditor. When accounting practices are inconsistent with the FARs, costs resulting from such practices shall not be allowed in excess of the amount that would have resulted from those consistent with the FARs.

The consultant is responsible for maintaining consistency in estimating, accumulating and reporting costs. All projects should benefit from the same accounting procedures and processes.

Unallowable Costs

FARs 31.201-6 requires that **unallowable** costs and any directly associated cost be identified and excluded from billings, claims or proposals for government contracts. In addition, **unallowable** costs must participate in indirect cost allocations just as they would if they were **allowable**. See Chapter 5 for a list of **common unallowable costs**.

Consultants are to maintain adequate records to establish and maintain the visibility of identified **unallowable** costs including directly associated costs. If a directly associated cost is included in a cost pool that is allocated over a base that includes the **unallowable** cost with which it is associated, the directly associated cost should remain in the cost pool. In all other cases, the directly associated costs, if material in amount, must be purged from the cost pool as **unallowable** costs.

Salary expenses for the time employees participate in activities that generate **unallowable** costs should be treated as directly associated costs provided the costs are material. Time spent by employees outside the normal working hours would not be considered unless the employee engaged in those company activities so frequently outside the normal working hours that it would indicate that the activities are a part of the employee's regular duties.

Financial Statements

Financial statements will vary depending on the company ownership, organization, size, etc. Publicly-held companies will generally have audited financial statements which includes the opinion of the CPA firm. Other entities may also have audited financial statements to serve the needs of lending institutions, owners, government agencies, etc.

Many smaller firms will have financial statements, which are compiled by accounting firms. In many cases, the accounting firms will also assist in preparing the Schedule of Indirect Costs.

In some cases, the financial statements will be prepared by internal accounting or management personnel.

In all cases the financial statements should include representations from management that the amounts are timely, accurate and in compliance with regulations that apply to their individual circumstances.

Disclosures

Disclosures are required to be included with financial statements and special schedules. This would include explanatory information about the financial data. Disclosures may describe the types of accounting systems and methods. They may describe the types of operations or contracts. A schedule of

Comment [FDOT29]: The assurances and disclosures required for Rate Audit reports submitted to the Department are discussed in Section 1, Part IV C. of the Department's Reimbursement Rate Audit Guidelines, 2005.

principal owners is often included. **Note: For examples of minimum disclosure requirements see Chapter 9.**

Examples are:

- Whether the statements/schedules are, or, are not, in compliance with authoritative pronouncements such as GAAP, FARs, etc.
- Extraordinary events that may have a material impact on the financial statement/schedule amounts must be disclosed.
- Direct cost items that the firm regularly charges to projects should be clearly identified in a footnote.

Management Representations

In working with consultants it is important for auditors to obtain written representations from management personnel. Specific representations will vary depending on the circumstances as well as other available information, such as audited financial statements. For indirect cost overhead engagements, auditors should request representations such as:

- the financial information is **accurate**
- the financial information is **complete**
- the information is in **compliance** with government regulations (i.e., FARs)
- estimates are based on **sound** financial data and **consistent** assumptions
- all actual indirect cost rates represented to any government body have been disclosed

In some contract audit environments, a management-certified cost proposal may be the starting point for the engagement and serves as management's representation. The auditor should consider obtaining additional representations on matters that arise during the course of the engagement.

Some states require annual submissions of financial, procedural, and other company information as well as Schedules of Indirect Costs. Some states require annual CPA audits/examinations of the Schedule of Indirect Costs.

Under the provisions of the Sarbanes–Oxley Act of 2002, publicly traded companies must now submit annual reports that are management representations of the company's internal control structure. Also required is the CPA firm's attestation of the internal control **reports**.

Comment [FDOT30]: The Department, and *Government Auditing Standards, 2003 Revision*, requires submission of the Auditor's Report on Compliance and Internal Control. When these reports contain significant or material findings with respect to Compliance or Internal Controls, management should prepare a Management Response Letter to the Auditor's report, stating their acceptance or objection to the finding(s). The Management Response Letter should be included as part of the Reimbursement Rate Audit Report in submissions to the Department.

Chapter

7

Chapter 7—Audit Considerations

Consultant indirect cost rates present unique and significant issues that auditors must consider when planning and performing engagements. For detailed information and guidance, the following are some publications that may be helpful (additional sources are listed in Chapter 12):

- Government Auditing Standards (“Yellow Book”) by U.S. General Accounting Office.
- Generally Accepted Auditing Standards, related Statements on Auditing Standards (SASs) and Statements on Standards for Attestation Engagements (SSAEs) by American Institute of Certified Public Accountants (AICPA)
- DCAA Contract Audit Manual by Department of Defense Contract Audit Agency
- Internal Control—Integrated Framework by Committee of Sponsoring Organizations (COSO) of the Treadway Commission
- OMB Circular A-123 Revised, Management’s Responsibility for Internal Control by U.S. Office of Management and Budget
- Auditing Standards promulgated by the Public Company Accounting Oversight Board (PCAOB) by SEC as a result of the Sarbanes–Oxley Act of 2002
- Cost Accounting Standards (CAS), 48 CFR, Chapter 99, by Cost Accounting Standards Board (CASB), an independent board located administratively within OFPP

It must be emphasized that auditors **must exercise significant judgment** in planning and performing engagements and take into consideration the unique circumstances involved with each government contractor and associated accounting systems. A wide variety of tools and publications may be helpful in determining the appropriate procedures, testing methods, and reporting formats.

Auditors must consider specific government regulations and individual contract provisions when designing and performing procedures.

Internal Controls

Management is responsible for maintaining an **effective internal control structure**. Much has been written in both the public sector and the government sector in recent years regarding appropriate internal control procedures. The unique requirements of cost-based government contracting require cycles and

elements of internal control that must be evaluated as part of the engagement. The following important elements must be considered during the auditor's evaluation of internal control of a consulting firm:

- Systems for monitoring compliance with government procurement regulations
- Estimating systems and proposal preparation practices
- Contract cost accounting practices
 - Systems for tracking and allocating labor cost
 - Systems for allocating non-labor direct costs
 - Systems for allocating costs through cost centers
- Billing procedures and controls
- Miscellaneous Revenues/Credits
- Change order identification, pricing, and reporting
- Cost aspects of related-party and inter-organizational transactions

Compliance with government procurement regulations is an important aspect for government contractors. Examples include compliance with **Cost Accounting Standards (CAS)** and **Federal Acquisition Regulations (FARs) Part 31**. Controls must be in place that are designed to provide reasonable assurance of compliance with applicable regulations. Management must ensure that employees are made aware of compliance policies and that procedures are carried out and updated as regulations change.

Controls over estimating systems and preparation of proposals are important so that management's risk of loss when signing a contract is minimized. The controls ensure that reliable cost estimates support contract proposals, that the cost data are accurate, current, and complete, that the source of cost data is well documented. The estimating process should be consistent and written policies and procedures should be maintained.

Contract cost accounting practices and systems are critical for government contracting. Well-controlled systems ensure that costs are distributed to cost objectives accurately and form a basis for comparing actual costs with estimated costs. Maintaining adequate controls provides reasonable assurance that:

- Costs are accurately distributed to cost objectives
- Costs are reasonable and in accordance with contract provisions
- **Unallowable** costs are segregated
- Cost-allocation practices are reasonable and in conformity with applicable CAS/GAAP
- Costs incurred on all projects are periodically reconciled to financial statements

Accounting for labor accurately is paramount to accurate cost-based accounting. Detailed records must be maintained, accumulated, and controlled to ensure that both the **direct labor** and **indirect labor** amounts are accurate. Procedures must be in place to ensure that direct labor charges are distributed to respective contracts. Indirect labor must be captured and assigned to appropriate indirect labor categories. The total of direct labor plus the indirect labor displayed in the general ledger must reconcile to the overall labor recorded in the payroll system for the period.

Other areas where management must devote significant attention include: **Disbursements/**

Expenditures, Allocations of Other Direct Costs, Billing Procedures, Related Party Transactions, and Interorganizational Transfers. Systems must be in place to ensure accurate recording of transactions. Controls must exist to insure that entries are reviewed and approved and that errors are promptly corrected. Management must maintain records to support the transactions and provide for an audit trail. Where integrated accounting systems are in place, management must have procedures to ensure that transactions are accurately recorded, summarized, and transferred through the systems.

Understanding the Consultant's Business

The auditor should obtain an understanding of the consultant's business. The following are examples of categories of information that may be obtained, as appropriate, and considered by the auditor in planning the engagement:

- The consultant's products and services, including the relationship of those products and services to cost-based government contracts
- The nature, size, and location of the consultant's operations
- Mix of government and commercial business
- Competition in the industry
- Types of contracts (lump sum, cost plus fixed fee, time, and materials)
- The consultant's accounting policies and procedures
- Key data for significant contracts including the following:
 - Government agency or department
 - Type of contract
 - Contract price
 - Revenues, costs, and profit/loss recognized to date
 - Incentive, escalation, or other relevant contract provisionsGovernment regulations affecting contract accounting such as state cost principles
- Key changes in operations, systems, or segments of the business
- CAS Disclosure Statement and Revisions if applicable
- Key information-processing systems
- Related party and inter-organizational transactions
- Litigation, claims, and disputes
- Prior audited indirect cost rates
- Prior filings with the SEC such as Form 10-K
- Minutes of the meetings of the board of directors
- Federal and state income tax returns

Consideration of Other Financial and Contract Audits

Information may be obtained from the contractor pertaining to other audits. These may include Audited Financial Statements (by CPA firm), audits by other SHAs, audits by local government agencies, audits by Federal government agencies (i.e., Defense Contract Audit Agency), or financial statement compilations/reviews by CPA firms.

Computerized Information Systems

The use of computers in the business environment is commonplace and is dynamic and rapidly changing. Therefore, the auditor must carefully assess the impact on the control environment. Accounting records may be maintained on a wide range of equipment including large host-based systems, networked environments, stand-alone PC applications and in some cases outside vendors (i.e., payroll services). The use of the internet is now common for transmitting data or for accessing regulations and other information involved in government contracting.

The auditor must apply the same standards for controls in highly automated or manual systems. However, the audit tests may vary significantly depending on the level of automation and integration of the systems. In certain instances auditors may need to employ experts to properly assess the internal controls. Particular attention should be focused on the contractor's internal controls as new automated accounting systems are implemented or significant upgrades are performed on old systems. Contractor personnel must be adequately trained on new systems and be knowledgeable of the impact of control procedures.

Audit Risk and Materiality

Audit risk involves the possibility that the auditor's testing and review may not detect material misstatements, mischargings or violations of government regulations. If the auditor's assessment of internal control risk is low, he/she may decide to accept a higher level of "detection risk" by limiting the audit procedures. When the internal control risk is considered to be high, the auditor will perform a greater amount of testing in order to reduce the detection risk.

When making risk assessments, auditors must consider materiality. Under GAGAS, the terms "material" and "significant" are synonymous. This is a highly judgmental area where auditors must perform risk assessments in order to determine appropriate levels of risk for the specific engagement. One of the additional (beyond the three AICPA standards) GAGAS standards relate to: **"detecting material misstatements resulting from violations of contract provisions or grant agreements or from abuse."**

GAGAS 4.04 states: **"Auditors should use professional judgment and consider the needs of users in applying the AICPA standards and related guidance to audits of a government entity or an entity that receives government awards. For example, auditors may need to set lower materiality levels than in audits in the private sector because of the public accountability of the audited entity, the various legal and regulatory requirements, and the visibility and sensitivity of government programs."**

GAGAS 4.17a states: **"Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from violations of provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives."**

GAGAS 4.18 states: **"AICPA standards and GAGAS require auditors to assess the risk of material misstatements of financial statement amounts or other financial data significant to the audit"**

Comment [FDOT31]: Because travel reimbursements under the Department's contracts are now based on the application of reimbursement rates, without vouchers or further review, audit procedures utilized in preparing direct expense Notes in Rate Audit reports for submission to the Department, or Supplemental Schedules of direct expenses, should include testing for compliance with the reimbursement limitations set forth in Florida Statute 112.061. This requirement may not be waived on the basis of the auditor's judgment with respect to the materiality of the costs involved, although testing may be limited based on the use of analytic measures. See Section 2 of the Reimbursement Rate Audit Guidelines, 2005, for further discussion.

objectives due to fraud and to consider that assessment in designing the audit procedures to be performed.”

Type and Volume of Contracts

The level of risk to a consultant varies depending on the type of contract (i.e., fixed-price-type or cost-type contracts). The audit emphasis changes depending on the types of contracts or the mix of contract types. If the consultant has primarily fixed-price (lump sum) contracts, the auditor would place more emphasis on the contractor's estimating procedures as well as those controls which are designed to ensure that all direct costs are excluded from indirect costs. If the consultant has primarily cost-type contracts the emphasis would be on allowability and determination that costs recorded are not in excess of specific contract limitations. Consultants with a mix of fixed price and cost type contracts require special emphasis on consistent allocation of costs regardless of whether contract revenues are based on cost incurred.

The relationship of a consultant's cost based government contracts to total contracts may have several impacts on the audit. Not only does this relationship impact the auditor's assessment of audit risk through materiality, the level of cost based contracts may have a significant impact on the control environment and management's commitment to internal control aspects unique to government contracting.

Chapter

8

Chapter 8—Audit Engagement Procedures

General

The following guidelines should be considered when developing specific audit procedures for consultant indirect cost rate engagements.

Labor Costs

In the majority of consultant contracts labor is the largest single component of cost. This component is made up of direct labor charges to the contract and indirect labor charges allocated to the contract through a factor or rate.

Verification of labor costs begins with the examination of the internal control structure and testing of those controls as discussed in Chapter 7. Once this assessment has been made the auditor can determine the size and depth of the audit sample for labor testing.

1. The labor sample should be tracked from employee time records to:
 - The payroll records to assure hours recorded are paid.
 - The cost system to assure hours are posted properly to jobs.
 - The general ledger to assure that the total posted is recorded in the financial accounting system.
2. The overall labor in general ledger accounts should be reconciled to:
 - The job cost system
 - The payroll reports submitted to the Internal Revenue Service (i.e., 941s).
3. Audit procedures should also determine if the labor accounts and individual time card entries sufficiently screen labor to:
 - Determine the allowability of payroll cost. (i.e., Do the records separate excess compensation and time spent on **unallowable** activities?)
 - Determine the proper allocation of labor. (i.e., Do the records charge all labor performed on similar tasks the same way?)
 - Determine if labor is posted in a manner from which the labor base can be computed. (i.e., If the base is direct labor without premium overtime do the records accumulate direct labor and direct premium overtime?)

Allocated Costs

Cost centers are developed to capture costs associated with a single purpose. The costs are assigned to objectives based on unit charges. Examples of categories for individual cost centers are printing, computers and vehicles. The over/under allocation of costs is usually handled as an adjustment to the overhead pool, which is where the cost would have been charged if it had not been directed to the cost center. If the over/under allocation is significant, consideration should be given to adjusting the contract charges.

Some accounting systems will attempt to adjust the unit charge rate for the over/under allocation of the cost centers. The goal of any cost center is to minimize the over/under allocation by the application of a properly estimated unit charge.

Audit issues of particular concern are:

1. Costs posted to the center are properly **allocable**. Do the costs belong to the function being priced?
2. Costs posted to the center are **allowable**. Do the costs exclude interest, profit, or other costs excluded under the FARs?
3. The unit charge records indicate the consistent assignment of all similar charges to projects.

Item three is the one most often overlooked by firms and can result in substantial adjustments.

Some firms do not choose to set up cost centers. These firms estimate the cost of providing certain services by pulling just certain elements from ledger accounts (i.e., automobile depreciation from a general ledger depreciation account). Once established, these unit charges are offset to overhead as they are utilized on projects. This type of costing is less precise and should not be utilized if the unit charges being accumulated are significant to the firm's overall operation.

Other Direct Costs

Invoices received from vendors or employees support these costs. They are processed through the cost accounting system and assigned directly to a project. The costs are not included in the overhead pool. Direct accounts should be established in the General Ledger and all similar costs should be posted to the accounts. Some examples are: project travel, vendor printing, employee mileage, rented vehicles and equipment, and subcontracts.

The audit procedures for these costs concentrate in two areas. The first area is the direct cost accounts themselves. The procedures are:

- Determine if costs are posted to the proper account and assigned to the correct projects.
- Determine if the costs are **allowable** in accordance with the contract and FARs.

The second area would concentrate on the overhead accounts. The accounts tested would be the ones similar in nature of cost to those charged to the direct accounts. The main audit efforts should be concentrated on:

Comment [FDOT32]: Beginning October 1, 2003, the Department no longer reimburses Contractors for direct costs based on invoiced actual costs or advance lump sum negotiation. With the exception of subcontract costs and extraordinary items which continue to be reimbursed on the basis of invoiced actual costs, all non-labor direct cost reimbursements in Department contracts are based on a direct expense reimbursement rate calculated in relation to the direct labor base. Direct costs reported in Rate Audit reports, or in Supplemental Schedules of direct expenses, must be reviewed against the standards in the FAR and Florida Statute 112.061 for disallowances.

- Determine if costs are consistently allocated to projects when they are incurred for similar purposes.
- Determine if costs are priced consistently to direct and indirect cost objectives.

Other Audit Procedures

Specific additional audit procedures are dependent upon the individual firm being audited. Certain audit steps that may be required for one firm are not necessary for another.

Several of these areas can be identified by a comprehensive preliminary review of the following information:

1. A detailed overhead rate schedule is needed to assure the auditee has separated **unallowable costs** as required by FARs.
2. An accounting and control survey is needed which will answer questions about possible areas of concern. Examples are:
 - Gains or losses on assets
 - Personal use of autos
 - Transactions with common control entities
 - Bonus plans
 - Direct costing policies
 - Acquisitions and re-structuring
 - Depreciation schedules
3. A tax return prepared for the fiscal year(s) being audited. Many areas addressed in the return are of concern to the Internal Revenue Service as well as for government contracting.
4. A disclosure statement (required by Cost Accounting Standards) when Federal contracts exceed a given amount as follows:
 - (1) Any business unit that is selected to receive a CAS-covered contract or subcontract of **\$50 million or more** shall submit a Disclosure Statement before award.
 - (2) Any company which, together with its segments, received net awards of negotiated prime contracts and subcontracts subject to CAS totaling **\$50 million or more in its most recent cost accounting period**, must submit a Disclosure Statement before award of its first CAS-covered contract in the immediately following cost accounting period. However, if the first CAS-covered contract is received within 90 days of the start of the cost accounting period, the contractor is not required to file until the end of 90 days.
 - (3) Other specific rules may apply and exceptions can be made in certain circumstances.

Chapter

9

Chapter 9—Reporting and Report Disclosures

General Reporting Considerations

The auditors' reports may take a variety of formats and styles, but they must meet the GAGAS

Reporting Standards for:

- Reporting Standards for Financial Audits, **or**
- Reporting Standards for Attestation Engagements

GAGAS reporting standards first incorporate the AICPA reporting standards for each type and then require additional GAGAS standards. There are a total of 10 standards for Financial Audits and 9 standards for Attestation Engagements. The complete text of the standards is available in the Yellow Book. See Chapter 2 for a summary matrix of the standards.

This chapter will provide basic guidelines for reporting and minimum disclosures that must be made by the consultant's management and included in auditors' reports. A typical report package contains the following:

- Independent Auditor's Report on Schedule of Indirect Costs
- Schedule of Indirect Costs
- Listing of Unallowable Account Adjustments with FAR References
- Notes to the Schedule of Indirect Costs—Minimum Disclosures
- Independent Auditor's Report on Internal Controls

The American Association of State Highway and Transportation Officials (AASHTO), Audit Subcommittee, and the American Council of Engineering Companies (ACEC) Transportation Committee have approved the report formats.

Auditor's Report on Schedule of Indirect Costs

The following is an example of a typical audit report that would be issued by a CPA firm or a State or Federal agency on the Schedule of Indirect Costs for a consulting engineering firm. If the auditor performed an "attestation engagement examination" the report wording would be modified, but in both cases an auditor's opinion is required. The complete report would include the Schedule of Indirect Costs and Footnote Disclosures (see following pages).

INDEPENDENT AUDITOR'S REPORT ON THE SCHEDULE OF INDIRECT COSTS

Board of Directors
The Company

We have audited the Schedule of Indirect Costs for the fiscal year ended December 31, 2004. This schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this schedule based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the financial audit standards contained in the *Government Auditing Standards* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the schedule is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Schedule of Indirect Costs. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

The accompanying schedule was prepared on a basis of accounting practices prescribed by Part 31 of the Federal Acquisition Regulations (FARs) and certain other Federal and state regulations as discussed in Note 2, and is not intended to be a presentation in conformity with generally accepted accounting principles.

In our opinion, the schedule referred to above presents fairly, in all material respects, the direct labor, fringe benefits and general overhead of the Company for the year ended December 31, 2004 on the basis of accounting described in Note 2.

In accordance with the *Government Auditing Standards* we have issued a report dated April 4, 2005 on our consideration of the Company's internal controls and its compliance with laws and regulations.

This report is intended solely for the use and information of the Company and government agencies or other customers related to contracts employing the cost principles of the Federal Acquisition Regulations and should not be used for any other purpose.

Bob Brooks, CPA, Director
External Audit Branch

April 4, 2005

Comment [FDOT33]: *Government Auditing Standards*, 2003 Revision, Rules 5.08 and 5.11, appear to require more explicit language; the reference to the report on compliance and internal controls may be inadequate. See Section 1, Part IV A. 2. of the Department's *Guidelines* for an expanded example.

Note: The following page displays a typical Schedule of Indirect Costs for a firm that has both Home Office and Field Office rates. **Unallowable** expense adjustments are clearly identified and referenced to appropriate FAR sections or to specific state regulations, where applicable.

Reimbursement Rate Audit Guidelines, 2005, Section 3
Florida Department of Transportation

HotShot Engineering Associates, Inc Schedule of Indirect Costs YE December 31, 2005						
Description	Financial Stmt Expense	Unallowable Expense	FAR Ref	Total Proposed	Home Office Costs	Field Office Costs
Direct Labor	\$ 12,500,000	\$ <u>12,000</u>	<u>(1)</u>	<u>\$12,512,000</u>	<u>\$ 12,011,520</u>	<u>\$ 500,480</u>
Fringe Benefits						
Vacation/Holiday/Paid Leave	1,700,000			1,700,000	\$ 1,632,000	\$ 68,000
Payroll Taxes	1,550,000			1,550,000	1,488,000	62,000
Group Insurance	1,100,000			1,100,000	1,056,000	44,000
Profit Sharing	1,016,000	(500,000)	(2)	516,000	495,360	20,640
Incentive Payments	1,550,000			1,550,000	1,488,000	62,000
Seminars/Education	400,000			400,000	384,000	16,000
Employee Welfare	10,000	(4,000)	(3)	6,000	5,760	240
Total Fringe Benefits	<u>\$ 7,326,000</u>	<u>\$ (504,000)</u>		<u>\$ 6,822,000</u>	<u>\$ 6,549,120</u>	<u>\$ 272,880</u>
General Overhead						
Non-Project Labor	\$ 4,900,000	\$ (12,000)	(1)	\$ 4,888,000	\$ 4,808,000	\$ 80,000
Recruiting	190,000			\$ 190,000	189,126	874
Building Costs (Rent)	1,400,000	(20,000) (4)		\$ 1,380,000	1,380,000	-
Other Occupancy Costs	464,000			\$ 464,000	464,000	-
Supplies	380,000			\$ 380,000	380,000	-
Field Supplies & Equipment	100,000			\$ 100,000	-	100,000
Postage & Shipping	78,000			\$ 78,000	77,641	359
Equipment Rent/Maintenance	386,000			\$ 386,000	384,225	1,775
Interest	20,000	(20,000)	(5)	\$ -	-	-
Telephone	290,000			\$ 290,000	288,667	1,333
Business Insurance	194,000			\$ 194,000	193,108	892
Legal & Other Professional Fees	376,000	(25,000) (6)		\$ 351,000	349,386	1,614
Administrative Travel	597,000	(30,000) (7)		\$ 567,000	564,393	2,607
Dues, Memberships & Reg.	173,000			\$ 173,000	172,205	795
Subscriptions & Publications	41,000			\$ 41,000	40,811	189
Depreciation/Amortization	628,000	(10,000) (8)		\$ 618,000	615,159	2,841
Outside Payroll Service	45,000			\$ 45,000	44,793	207
State Income & Personal Property Taxes	27,000			\$ 27,000	26,876	124
Direct Cost Credit	(833,000)	-		\$ (833,000)	(829,170)	(3,830)
Total General Overhead	<u>\$ 9,456,000</u>	<u>\$ (117,000)</u>		<u>\$ 9,339,000</u>	<u>\$ 9,149,221</u>	<u>\$ 189,779</u>
Total Indirect Costs				<u>\$ 16,161,000</u>	<u>\$ 15,698,341</u>	<u>\$ 462,659</u>
Percent of Direct Labor				<u>129.16%</u>	<u>130.69%</u>	<u>92.44%</u>
Facilities Capital Cost of Money (FCCM)				<u>\$ 62,505</u>	<u>\$ 62,505</u>	<u>=</u>
Percent of Direct Labor				<u>0.50%</u>	<u>0.52%</u>	<u>0.00%</u>
FAR References: (1) 31.202 – Uncompensated overtime or salaried employees considered to be direct labor, and removed from indirect labor cost. (2) 31.205-6(a)(i)(A) & (B) - Compensation paid to owners in excess of reasonable amount and considered distribution of profits. (3) 31.205-6(m)(2) - Portion of the cost of company-furnished automobiles that relates to personal use by employees. (4) 31.205-14 - Costs of dues for social clubs is unallowable and considered entertainment. (5) 31.205-36 - Adjust rental costs to actual costs incurred to eliminate markups between subsidiaries under common control. (6) 31.205-20 - Interest and other financial costs not allowable. (7) 31.205-27 - Accounting and legal fees considered as organization costs are not allowable. 31.205-49 - Amortization of acquisition intangibles (goodwill).						

Report on Internal Control

Note: The following is an example of a report on internal control with no reportable conditions, which is a GAGAS requirement for financial audits (See Chapter 2). For both financial audits and attestation engagements auditors reports should disclose deficiencies in internal control, fraud, illegal acts, violations of contracts or grant agreements, and abuse. (See the Yellow Book for specific reporting requirements)

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROLS

Board of Directors
The Company

We have audited the Schedule of Indirect Costs of the Company for the fiscal year ended December 31, 2004, and have issued our report thereon dated April 4, 2005. We conducted our audit in accordance with generally accepted auditing standards and the financial audit standards contained in the *Government Auditing Standards* issued by the Comptroller General of the United States of America.

Compliance

As part of obtaining reasonable assurance about whether the Company's schedule is free from material misstatement, we performed tests of the Company's compliance with certain provisions of laws, regulations and contracts, including the provisions of the applicable sections of Part 31 of the Federal Acquisition Regulations, noncompliance with which could have a direct and material effect on the determination of the schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Company's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the schedule and not to provide assurance on internal control over financial reporting. The management of the Company is responsible for establishing and maintaining internal control over financial reporting. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control over financial reporting. The objectives of internal control over financial reporting are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with the Federal Acquisition Regulations Part 31. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal controls over financial reporting in the following categories: cash disbursements and payroll.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal controls over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the use and information of the Company and government agencies or other customers related to contracts employing the cost principles of the Federal Acquisition Regulations, and should not be used for any other purpose.

Bob Brooks, CPA, Director
External Audit Branch

April 4, 2005

Minimum Report Disclosures

The following represent disclosures that should be included, with reports, whether they are financial audits or attestation engagements or reports submitted by management of the company. In cases where examples are included, they are for illustrative and explanatory purposes only and are not intended to be all-inclusive regarding rules and regulations. Some may not be applicable for certain firms. Additional disclosures may be required for unusual or complex issues. Disclosures should be included with the schedule of Indirect Costs for each fiscal year. They may be included in the Notes to the Schedule of Indirect Costs or as a separate submission provided by management.

1. DESCRIPTION OF THE COMPANY

Provide an overview of the company including when the company was formed, type of organization (e.g., corporation, LLC, LLP, etc.), major business activities, primary customer groups, type of ownership (e.g., subsidiary of corporation, division of another company, privately held firm) and any other pertinent general company information.

2. BASIS OF ACCOUNTING

The basis of accounting practices should be clearly stated.

Example

The Company's Schedule of Indirect Costs was prepared on the basis of accounting practices prescribed in Part 31 of the Federal Acquisition Regulations (FARs). Accordingly, the schedule of indirect costs is not intended to present the results of operations of the Company in conformity with accounting principles generally accepted in the United States of America.

3. DESCRIPTION OF ACCOUNTING POLICIES

Describe the financial accounting system (cash, accrual, hybrid, etc.) and job cost accounting system (job order, modified job order, standard, hybrid). Include a description of accounting policies and procedures governing the classification of costs as direct or indirect. Describe how project costs are accumulated and assigned to projects.

4. DESCRIPTION OF OVERHEAD RATE STRUCTURE

Disclosures should include:

- Identifying the Reporting Unit [e.g., company wide, business segment, technical specialty (design, construction administration, geotechnical, environmental, etc.) or geographical location] pertaining to the overhead rate(s).

Identifying the company's overall rate structure in terms of the base(s) for allocation. Describe if more than one base is used, depending on the customer (e.g., Federal or state project).

Examples:

Single Base

All costs are allocated to Direct Labor

Multiple Bases

Fringe Benefits—allocated to Direct + Indirect Labor Office Overhead—allocated to Direct Labor + Fringes General & Administrative—allocated to Value Added Costs (All company costs excluding sub consultants)

- Identifying whether a dual rate structure exists for Field Office projects and Home Office projects. Specify the allocation methods used.
- Identifying that Direct Project Costs, sometimes referred to as Other Direct Costs (ODC) are consistently charged to all projects, and not just projects that reimburse for ODCs (i.e., computer costs, reproduction, equipment charges and vehicle usage). Include a listing of cost items generally charged directly to projects.
- Identify cost allocation practices between related business entities (e.g., parent company allocating costs to subsidiaries or divisions, allocations between subsidiaries or divisions, allocations to specific product lines, etc.).

5. DESCRIPTION OF LABOR RELATED COSTS

- **Project Labor**
- Describe how the company charges labor to all projects (i.e., actual, average, or standard hourly rates).
- **Variances**
Describe how and when variances are recorded if using other than actual labor costs.
- **Paid Time Off**
Explain the company's policy and accounting practice as to paid vacation, sick leave, and comp time. Include the consultant's policy as to accounting for accrued sick leave upon termination.
- **Paid Overtime and Uncompensated Overtime**
Indicate where the premium portion of overtime pay is recorded in the cost accounting system. Detail the procedures for recording uncompensated overtime incurred by employees charging direct project time.

Examples:

Premium Overtime: Costs are incurred in meeting certain deadlines. If an employee is eligible for overtime, they have their choice of a cash payment equal to time and a half (premium portion), or compensatory time off at time and a half. The premium portion of paid overtime is included in the indirect cost pool.

Uncompensated Overtime: The Company did not pay certain salaried employees for time worked in excess of 40 hours per week. The time in excess of 40 hours was credited to the indirect cost pool. The credited amount (\$xx,xxx) consisted of hours worked in excess of 40, times the employee's standard hourly rate.

- **Highly Compensated Employees/Officers/Owners**
FAR §31.205-6(p) sets a specific dollar limit on the compensation [total compensation as

defined in FAR §31.205-6(a)] of “senior executives. Other bases (such as independent salary surveys) may be used to determine reasonable compensation levels. The reasonable compensation limit or range that was used by the auditor should be disclosed in the notes to the audit report. Distributions of profits to owners are unallowable as direct or indirect labor costs.

The Company paid compensation to senior executives in excess of the FAR §31.205-6(p) limit of \$342,986 per person. The total, which was adjusted to the Schedule of Indirect Cost Pools, amounted to \$XXX,XXX.

Example:

- **Pension Plans/Deferred Compensation/ESOP**

If pension and/or deferred compensation costs (as defined by FARs §31.205-6(j) and §31.205-6(k) respectively) are included in indirect costs, identify whether the plan(s) meet the above regulations and explain how the costs were determined (e.g., cash contribution, stock or options to purchase stock of the consultant, assets other than cash).

In regard to Employee Stock Option Purchase (ESOP) plans, identify the dollar amounts of principal, interest, and administrative costs of the contribution to the Employee Stock Option Trust (ESOT). Identify any other significant impacts from market valuations, etc.

The Company has a 401(k) pension plan, meeting the requirements of FARs §31.2056(j), to which it makes a cash contribution of two percent of employee salary per year.

In addition, the Company has a leveraged deferred compensation ESOP started in 1984. The plan provides for cash payments of the appraised value of the stock (held by the ESOT for the employee) upon retirement, leaving the Company after 10 years service, or death. Since CAS 9904.415(a)(3) has not been satisfied, the Company assigns the payments to the period in which the compensation is paid to the employee. The amount of the company’s share of ESOP expense included in the overhead pool for the year is \$ xxx,xxx.

Example:

- **Contract Labor**

Provide the methodology used by the consultant to account for contract labor (not sub-contracts). In some cases this labor will be considered to be a direct cost item invoiced to the project, but in other cases the firm may choose to have this labor treated the same as employee labor, and therefore it would be included in the direct labor base.

Example:

The Company uses contract labor for engineering related services, and bills this labor as if it were for regular employees. The Company provides office space, administrative support, and controls the contract laborers. Therefore, contract laborers are considered employees, and their labor costs (\$52,000 for the period audited) have been included in the direct labor base.

6. DESCRIPTION OF DEPRECIATION/LEASING POLICIES

Policies regarding costs related to acquisition and disposition of assets should be clearly identified along with the related depreciation methods. Costs and accounting treatment for capital and operating leases should be disclosed.

Example:

Certain assets are purchased and depreciated, while others are leased and considered operating leases, and the annual lease costs are included in the overhead pool.

The depreciation reflected on the Company's financial statements differs from the acceptable depreciation for Federal income tax purposes. Since the financial statement amounts included in the overhead pool are lower than the amounts used for Federal purposes, the amounts included in the Schedule of Indirect Cost Pools are allowable under FAR §31.205-11(e).

7. DESCRIPTION OF RELATED PARTY TRANSACTIONS

Identify any related parties, who are considered to have common control, to the extent that audit adjustments are required, and the amounts of required FARs adjustments [per §31.205-26(e) and §31.205-36(b)(3)].

Note: When determining actual costs for related party charges Facilities Capital cost of money may be included as a cost of ownership of the related party tangible assets.

Example:

The Company rents one of its two offices from a Limited Liability Partnership partially owned by a company shareholder. The actual occupancy costs of \$350,000 include interest expense of \$140,500. The rent expense recorded in the Company's financial statements includes a \$400,000 charge from the related party LLP. The calculation to

determine the allowable portion of the rent would be:

Total rent expense recorded (from related LLP)	\$400,000
Less: Profit included in rent charges	(50,000)
Less: Unallowable interest expense	<u>(140,500)</u>
Allowable portion of related party rent	\$209,500

Consequently, rental expense has been adjusted downward by \$190,500 to reflect the provisions of FARs §31.205-36(b)(3). The officers of the Company have personal usage of Company vehicles. Amounts attributable to this personal use (\$X,XXX for 20xx) were disallowed.

8. FACILITIES CAPITAL COST OF MONEY (FCCM)

Provide the cost-of-money rate, as calculated in accordance with FAR §31.205-10.

The cost-of-money rate has been calculated in accordance with FAR §31.205-10, using average net book values of equipment and facilities multiplied by the average treasury rate for the applicable period. Equipment and facilities include furniture and fixtures, computer equipment, vehicles, and leasehold improvements. The calculation was made

as follows:

12/31/xx

Net Book Value of Corporate Assets	\$267,520
Average Treasury Rate	5%
Computed Facilities Capital	<u>\$ 13,376</u>
Direct Labor Base	\$1,042,535
Cost-of-Money Rate	<u>1.28%</u>

Example:

Chapter

10

Chapter 10—Reliance on Other Audits

In order to avoid duplication of audit work it is common practice for auditors to rely on the work of others. GAGAS 4.25 states:

“Underlying GAGAS audits is the premise that Federal, state, and local governments and other organizations cooperate in auditing programs of common interest so that auditors may use others’ work and avoid duplication of audit efforts. Auditors should make arrangements to make audit documentation available, upon request, in a timely manner to other auditors or reviewers. Contractual arrangements for GAGAS audits should provide for full and timely access to audit documentation to facilitate reliance by others on the auditors’ work.”

Additional guidance is provided in GAGAS 7.33.

NHS Act—Section 307

In 1995, Congress passed the latest version of the National Highway System Designation Act (see www.fhwa.dot.gov/infrastructure/progadmin/consultant.) The focus of Section 307 of this act was to remove the ceilings on overhead rates and indirect salaries that had been established by some states, avoid duplicate indirect cost audits of the same firm by multiple audit entities, and reinforce the need for all audit entities to use the Federal Acquisition Regulations for the purpose of determining cost eligibility.

This legislation impacted how some states paid consulting engineers for the overhead portion of their costs on federally participating contracts. Heretofore, approximately half the states had self-imposed ceilings on overhead limits and/or maximum hourly rates associated with indirect labor. Section 307 of the NHS Act prohibited the use of such limitations on federally participating contracts.

The NHS Act, however, did provide a one-year window for states to adopt statutes that would establish “an alternative process intended to promote engineering and design quality and ensure maximum competition.” If a statute were adopted by a state within this period, Section 307 would not bind the state. The deadline was ultimately extended to 6/9/98 and thirteen states adopted such statutes within the allowed time period. Such states are referred to as “opt out states.” They are: CT, DE, FL, KY, LA, ME, MD, MN, NY, NC, UT, TN, WV.

Comment [FDOT34]: Section 174 of the FY 2006 Transportation Appropriations Act eliminated the authority of all but two states (MN and WV) to “opt out.” The Department now participates in the statutory plan.

Note: The current Federal budget legislation (for years 2005–2006) contains language, which, if passed, proposes to eliminate the concept of “opt out states, and therefore promote greater uniformity.”

Cognizant Agency/Cognizant Audits

Section 307 also strived to establish an audit environment that was uniform among the states and not duplicative. Uniformity was to be achieved by requiring states or other audit entities to use the cost principles found in the Federal Acquisition Regulations (Part 31 of Title 48, Code of Federal Regulations) when performing cost audits of consulting engineering firms. Many states had previously used the Federal Acquisition Regulations to determine eligibility of indirect costs on engineering contracts.

The avoidance of duplicate audits was addressed in Section 307 through the introduction of the term **“cognizancy.”** This term laid the groundwork for states and other audit entities to be required to use the work of others if an audit had been previously performed by a “cognizant agency.” Unfortunately, Section 307 did not provide a definition for cognizant agency. In order to develop an acceptable definition of cognizant agency and cognizant audit, the American Association of State Highway and Transportation Officials (AASHTO) Audit Subcommittee and the American Council of Engineering Companies (ACEC) Transportation Committee joined forces to develop acceptable definitions of these terms that could be used by the Federal Highway Administration when adopting rules for the implementation of Section 307.

The AASHTO Audit Subcommittee and the ACEC Transportation Committee unanimously adopted the following definitions for these terms during their meetings conducted during the late summer of 2000.

A **“Cognizant Agency”** is any one of the following:

- Federal Agency
- The Home State Transportation or Highway Department (i.e., state where the firm’s accounting and financial records are located)
- A Non-Home State Transportation or Highway Department to whom the Home State has transferred cognizance in writing for the particular indirect cost audit of a firm.

A **“Cognizant Audit”** is achieved by any one of the following methods:

- A Cognizant Agency performs or directs the work of a CPA who performs the indirect cost audit.
- Non-Home State auditor or CPAs working under this State’s direction issue an audit report and the Home State issues a letter of concurrence. If the Home State does not accept the audit of another State, the Home State will have 180 days from receipt to issue a cognizant audit; otherwise, the Non-Home State audit report will be cognizant for the one year applicable accounting period.
- An indirect cost audit performed by a CPA hired by the firm will become a cognizant audit if one of the following conditions is met:
 - (a) The Home State reviews the CPA’s working papers and the Home State issues a letter of concurrence with the audit report.

- (b) A Non-Home State reviews the CPA's working papers and issues a letter of concurrence with the CPA report, which is then accepted by the Home State. If the Home State does not accept the Non-Home State's review, the Home State will have 180 days from receipt to complete a review of the CPA audit report and either concur with it, modify it, or reject it due to a material error requiring re-submittal; otherwise, the CPA audit report with which the Non-Home State has concurred will be cognizant for the one year applicable accounting period.

Guidelines for the review are in the next section of this chapter.

FHWA Final Rule: Administration of Engineering and Design Related Service Contracts

FHWA issued the final rule in July 2002 (see 23 CFR 172 Subpart A). The FHWA considered the above definition of Cognizant Audit but believed that more testing of the procedures would be required. Therefore the definition was not included in the final rule.

The definition of **Cognizant Agency** was adopted in the final rule as follows:

“Any Federal or state agency that has conducted and issued an audit report of the consultant's indirect cost rate that has been developed in accordance with the requirements of the cost principles contained in 48 CFR part 31.”

In October 2002, FHWA issued a “Supplemental Guidance Document for 23 CFR 172, which provided information in a Question & Answer format that specified how to achieve cognizant audits. For the most part, the recommendation of AASHTO subcommittee was adopted in the FHWA guidance.

Guidelines for Reviewing CPA Indirect Cost Audits

In addition to the above definitions, the AASHTO Audit Subcommittee adopted guidelines to be used in reviewing indirect costs audits performed by public accounting firms and issuing letters of concurrence. The following minimum guidelines should be followed when a state transportation/highway department audit organization reviews a CPA indirect cost audit report and issues a letter of concurrence.

The reviewing state should obtain documentation that evidences the CPA's accomplishment of the continuing education requirements identified in paragraphs 3.45 thru 3.48 and the external quality control review requirements found in paragraph 3.49 of Yellow Book.

- The reviewing state should determine that the CPA's audit report format is in material compliance with the Uniform Indirect Cost Rate Audit Report Format for Engineering Consulting Firms prepared and adopted by the AASHTO Audit Subcommittee and the ACEC Transportation Committee.
- The reviewing state should determine that the CPA audit was conducted in accordance with the General Standards, Field Work Standards and Reporting Standards for audits as described in Chapters 3, 4, and 5 of the Yellow Book. The review should also determine compliance with Part 31 of the Federal Acquisition Regulations.

Comment [FDOT35]: The Department envisions two separate review actions included within this sentence. All indirect cost audit reports submitted to the Department will be reviewed for apparent compliance with *Government Auditing Standards* and FAR cost principles. The Department will issue a letter of concurrence only upon the request of another governmental contracting authority, and only after completing the additional review steps discussed below.

The following steps should be performed to make these determinations:

1. Review of the audit report.
2. Discussions with CPA auditor, if available.
3. Review the CPA's working papers. CPA's must provide access to working papers.
4. Request any additional supplemental tests the reviewing state deems necessary.

The reviewing state upon satisfactory completion of this review shall issue a letter of concurrence with the CPA's indirect cost audit report of the firm. Documentation to support this review shall be retained by the reviewing state for a minimum of three years from the date of the letter of concurrence. The letter of concurrence shall be addressed to the audited firm and signed by the head of the audit organization, or a designee.

Chapter

11

Chapter 11—Glossary of Terms

The following terms are used throughout this guide:

Actual Cost Agreement

The term Actual Cost Agreement does not mean that a consultant will be reimbursed for all actual costs incurred for performing a job. Costs are reimbursed subject to the limitations described in the agreement, contract, or specified criteria. These limitations can be very restrictive. An example is interest on borrowed money. This is a cost of doing business, yet it is not reimbursable as an actual cost of doing business.

Actual Costs

Amounts determined on the basis of costs incurred and supported by original source documentation, as compared to forecasted costs, or costs thought to have been incurred, or costs based on historical averages.

Advance Agreement

An understanding included in an agreement by the contracting officer and the consultant as to the treatment of special or unusual costs not already included in FARs. The agreement must be in writing, executed by both the contracting parties, and incorporated into applicable current and future contracts. An advance agreement shall contain a statement of its applicability and duration. See 48 CFR 31.109.

Agreement

A contract. A binding, legal, document which identifies the deliverable goods and services being provided, under what conditions, and the method of payment for such services. The document may include Federal criteria and state requirements which will have to be adhered to by the state and the consultant. The document will usually indicate start and finish dates, record retention requirements, and other pertinent information relative to the actual work to be performed.

All-Inclusive Hourly Rate Agreement

An agreement using an hourly rate developed for billing purposes which may include a firm's actual direct labor cost, overhead rate allowed or negotiated, and negotiated profit margin. Provisional hourly rates generally are temporary and will be adjusted by an audit. Negotiated hourly rates may be used for the life of an agreement, or may be adjusted from time to time depending on the agreement provisions.

Allocable

A cost is allocable (to an agreement or cost of work being performed for the government) if it benefits both the agreement and other work of the firm and the cost can be distributed in reasonable proportion to the benefits of incurring that cost.

Allowable (Cost)

An item of cost that can be billed directly as a project cost or indirectly as an overhead cost by the consultant.

Audit Cycle

The series of steps auditors go through in completing their assigned work. The process includes a review of a firm's permanent file maintained by the Audit Office, preliminary audit work including scheduling of billed costs, arranging an appointment to conduct the audit, entrance conference, field work, review of a firm's documentation, exit conference, report write up, submittal of draft report to auditee for comment, and issuance of the final report.

Audit Resolution Process

The process that SHA management and the auditee go through in resolving audit findings. It may involve negotiation of a settlement, legal counsel, and court procedures.

Audit Trail

The auditable record left by a transaction in a firm's accounting records from original source document into subsidiary ledgers through the general ledger and into financial statements and invoices.

Billing Rate

The billing rate generally refers to the hourly labor rate being charged for work on an agreement. For a cost plus fixed fee agreement, the billing rate will be the employee's actual payroll rate. For an all-inclusive hourly rate agreement, the billing labor rate will include the actual payroll rate plus an overhead percentage plus an amount for fee.

Cognizant Audit

This concept was developed to assign primary responsibility for the audit to one organization and to avoid duplication of audit work when auditing the indirect cost schedule. The audit work may be done by the home state auditors, a Federal audit agency, a CPA firm, or a non-home state auditor designated by the home state auditor.

Common Control

Exists in related party transactions when business is conducted at less than arm's length between businesses and/or persons that have a family or business relationship. Examples are transactions between family members, transactions between subsidiaries of the same parent company, or transactions between companies owned by the same person or persons.

Contracting Officer

A title sometimes used in private and public sectors to indicate the person having authority to enter into a contract or agreement for goods and services.

Corporation (C-Corp)

A business structure where stock is made available for purchase. The firm may have a president, vice president, treasurer, and secretary. Anyone working for the corporation is usually paid an hourly wage rate or is salaried. In theory, the liabilities of the individual stock owners are limited in this type of business structure.

Other forms of business organizations include: Limited Liability Corporations (LLC), Limited Liability Partnerships (LLP) and Sub-Chapter S Corporations. Each has varying levels of liability for owners and each has different Federal Income Tax provisions.

Cost Accounting Standards

Cost Accounting Standards (CAS) are the rules, regulations and standards, which are promulgated by the Cost Accounting Standards Board (CASB). The CASB is located within the Office of Federal Procurement Policy, which is under the direction of the Office of Management and Budget (OMB) of the Federal government.

Cost Center

Cost centers are used to accumulate and segregate costs.

Cost Objective

An agreement, contract, function or organizational subdivision for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

Cost of Money

Facilities capital cost of money in an imputed cost determined by applying a cost-of-money rate to facilities capital employed in contract performance.

Cost Plus Fixed Fee Agreement

An agreement in which all the cost factors except fee are actual cost. The fixed fee is a set dollar amount in the agreement.

Cost Principles

The underlying basis for determining how costs should be recorded when they are allowable or unallowable, and the specific basis for treating various costs as either allowable or unallowable.

Courtesy Audit

An audit performed for another state, another state agency, or city or county government. The audit could be a preaward, interim or post, with the requesting agency paying for the cost of the audit.

Direct Cost

Any cost that can be identified specifically with a particular final cost objective, i.e., a project related cost. Direct costs would include labor, materials, and reimbursables incurred specifically for an agreement. It is irrelevant whether or not the costs are actually billed. All direct labor costs must be included in the direct labor base. All costs for lump sum agreements must be included in direct costs.

Entrance Conference

A meeting between the auditor and the auditee, at which time the purpose and scope of the audit are discussed.

Exit Conference

A meeting held after the auditor completes field work at the auditee's place of business. Topics of discussion are preliminary findings of the audit, which are subject to change and revision during the supervisory workpaper review process, and/or a formal request for the auditee's response to the draft audit report.

Federal Acquisition Regulations (FARs) Code of Federal Regulations No. 48

Sets the criteria for allowable and unallowable costs for federally funded agreements. The FARs are also used as a guideline for other government contracting such as State contracts. Part 31.2 is the primary section pertaining to State Highway Agencies.

Finding

A statement of noncompliance with the terms of an agreement. A finding includes the condition, criteria, cause, effect, and a recommendation for correction.

General and Administrative Expenses

Any management, financial, and other expense which is incurred by or allocated to a business unit, and which is for the general management and administration of the business as a whole.

Generally Accepted Auditing Standards (GAAS)

These are standards for financial statement audits set forth by the American Institute of Certified Public Accountants. The standards pertain to auditors' professional qualifications, the quality of audit effort, and the characteristics of professional and meaningful audit reports.

Generally Accepted Governmental Auditing Standards (GAGAS)

These are standards for audits of government organizations, programs, activities, and functions, and of government assistance received by contractors, nonprofit organizations, and other non-government organizations. These standards also incorporate GAAS for financial-related audits.

Indirect Cost

Any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective. Consultants recover their indirect costs in their overhead rate.

Interim Audit

An audit, which may be of limited scope, during the life of an agreement. The purpose is to determine the actual allowable costs to date, review and adjust a firm's overhead rate, and audit a prime consultant's subcontracts. This audit follows a standard audit plan.

Internal Control

The plan of organization and methods and procedures adopted by management to ensure that its goals and objectives are met; that resources are used consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Lump Sum (Fixed Price) Agreement

An agreement where the method of payment for delivery of goods and services is one set amount that includes salaries, overhead, and profit with no adjustments. Once the lump sum amount is agreed upon, the services or goods must be provided regardless of the actual cost to the consultant.

Negotiated Hourly Rate Agreement

An agreement in which hourly billing rates that include labor, overhead, and fee are negotiated in advance and are listed for a 12-month period or more.

Overhead Expenses

All allowable general administrative expenses and fringe benefit costs (sometimes called payroll additives). Depending on the size of the firm, these costs may or may not be separately identified on a schedule of overhead costs.

Overhead Rate

A computed rate usually developed by adding together all of a firm's costs that cannot be associated with a single cost objective, including general and administrative costs, fringe benefit costs, then dividing by a base value, usually direct labor dollars, to get a percentage. This rate is applied to direct labor to allow a firm to recover the share of indirect costs allowable to the agreement.

Overtime Compensation

Compensation paid to employees who work more than a certain amount of hours within a pay period, usually 40 hours. The pay rate may be based on the normal salary rate or may include "premium overtime" such as time and a half, or double time. In most cases, premium overtime is required for hourly workers and is optional for certain salaried employees.

Partnership

A business with two or more co-owners, who may or may not have established salaries. The liabilities of the firm are the owners' responsibility. Owners may be treated the same as sole proprietors by the auditors regarding the establishment of a salary rate.

Post Audit

An audit done after the completion of all work by a consultant. Its scope may include all billed costs by the prime consultant and/or any sub consultants providing services. This audit follows a standard audit plan.

Pre-Award Review

An audit conducted on behalf of SHA management for the purpose of validating financial information supplied by a potential contractor. The audit may require an on site visit or information may be reviewed at the Audit Office. Upon completion, the information is provided to the SHA contracting officer in an audit report for use during agreement negotiations. This audit follows a special pre-award audit plan.

Provisional Hourly Rate Agreement

An agreement in which hourly billing rates that include labor, overhead, and fee are negotiated in advance, but are subject to adjustment after an audit determines actual labor and overhead rates.

Reasonable Cost

A cost, if in its nature and amount, does not exceed that which would be incurred by a prudent person in the conduct of competitive business.

Record of Negotiation

A summary memorandum prepared by the SHA contracting officer regarding the reconciliation between the consultant's proposal and the SHA estimate. It includes contract rate negotiations, disposition of significant matters in the pre-award audit report, and reasons why audit recommendations were not followed. It is required by 48 CFR 42.706(b).

Single Audit

In theory, an audit which satisfies the needs of all parties involved with funding or doing business with an organization, either private or public.

Sole Proprietorship

A business with one owner. From an audit standpoint, this person may not have an established salary, but instead may rely on draws from the profits of the firm to obtain their payment for services.

Source Documentation

Original documents, including but not limited to time sheets, invoices, hotel receipts, rental slips, gasoline tickets, canceled checks, tax returns, insurance policies, minutes of corporate meetings, etc., which support the costs recorded in the firm's accounting ledgers and which may be used for billing purposes to the government or for income tax purposes.

Task Assignment Agreements

An agreement without a definite description of work, but with a specified time period. Tasks which require the consultant's expertise are assigned as needed. Each task will have its own maximum payable amount. The total amount paid on all of the tasks cannot exceed the total amount of the agreement.

Unallowable (Cost)

An item of cost which cannot be billed directly or indirectly by a consultant. These types of costs, if found during an audit will be purged from the costs billed directly, or from those billed indirectly via an overhead rate or cost center. When an unallowable cost is incurred, its directly associated costs are also unallowable.

Chapter

12

Chapter 12—Listing of Resource Materials

This section provides a listing of resource materials that are commonly used as guides by auditors in performing government contract audits. The listing is not all-inclusive but attempts to highlight the most frequently used materials. While paper copies are available most of the publications are now also available on CD-ROM disks or via the internet. These are especially useful because of the built-in search features that enable the users to quickly find specific information.

Government Auditing Standards—2003 Revision (“Yellow Book”)

Published by:

United States General Accounting Office (GAO), by the Comptroller General

Current version available at: <http://www.gao.gov/govaud/ybk01.htm>

Purpose: (quote from introduction)

“Government Auditing Standards (the “Yellow Book”) contains standards for audits of government organizations, programs, activities, and functions, and of government assistance received by contractors, nonprofit organizations, and other non-government organizations. These standards, often referred to as generally accepted government auditing standards (GAGAS), are to be followed by auditors and audit organizations when required by law, regulation, agreement, contract, or policy. These standards pertain to auditors’ professional qualifications, the quality of audit effort, and the characteristics of professional and meaningful audit reports.”

Federal Acquisition Regulations (FARs)

Published jointly by:

United States Department of Defense (DOD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA)

Format:

Available in paper, CD-ROM and on the Internet at www.arnet.gov/far. Another way to access the web site is at the Federal Government main home page www.firstgov.gov, then search for “Federal Acquisition Regulations.”

Reimbursement Rate Audit Guidelines, 2005, Section 3
Florida Department of Transportation

Contained in:

Code of Federal Regulations at 48 CFR Chapter 1

Relevant Part:

Part 31—Contract Cost Principles and Procedures

Purpose:

Provides primary authoritative guidelines for acquisition of supplies and services by government agencies. Provides detailed explanations of specific rules for allowable and unallowable costs.

DCAA Contract Audit Manual

Published by:

United States Department of Defense, Contract Audit Agency (DCAA)

Formats:

Two-volume set of paper manuals published twice per year

Available on CD-ROM called “Defense Acquisition Deskbook”

Available on the internet via the Acquisition Knowledge Sharing System (AKSS) at:

<http://www.dcaa.mil/cam.htm>

Purpose (quote per manual):

“This manual is issued to provide technical audit guidance, audit techniques, audit standards, and technical policies and procedures to be followed by DCAA personnel in the execution of the contract audit mission.”

American Institute of Certified Public Accountants (AICPA)

Published by:

The AICPA is the premier national professional association for CPAs in the United States. This organization produces numerous publications to assist accountants and auditors in following accounting principles and auditing standards.

Formats:

1. AICPA materials are generally available in hard-copy form in a variety of formats including Audit and Accounting Guides, Audit Guides, Professional Standards Binders, Statements of Position, Newsletters, Exposure Drafts, and others.
2. All of the AICPA’s professional literature is available on CD-ROM with built in search capabilities.
3. Many of the materials are available on the internet at the AICPA web site which is:
<http://www.aicpa.org>

Partial Listing of Helpful Materials:

1. AICPA Professional Standards (Two-Volume Set)
2. Audits of Federal Government Contractors—Audit and Accounting Guide
3. Auditing Recipients of Federal Awards: Practical Guidance for Applying OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations
4. Codification of Statements on Auditing Standards
5. Accounting Trends and Techniques—CD-ROM
6. Audit Sampling—Auditing Practice Release
7. Auditing in Common Computer Environments—Auditing Practice Release
8. Codification of Statements on Standards for Attestation Engagements

Accounting Standards—Current Text

Published by:

Financial Accounting Standards Board

Format:

Hard-copy, three-volume set

Website address: <http://www.fasb.org/>

Purpose:

This guide is an integration of currently effective accounting and reporting standards. Material is drawn from AICPA Accounting Research Bulletins, APB Opinions, FASB Statements of Financial Accounting Standards, and FASB Interpretations. While its focus is primarily publicly traded corporations, some of the material may be helpful for government auditors.

Federal Travel Regulation

Provides information on travel guidelines for Federal government rates, etc.

Website: <http://www.fedtraveler.com/>

Chapter

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Chapter 13—Other General Information

Acknowledgements

The concept of developing an audit guide to assist engineering consultants, CPAs and state auditors with the preparation of Schedules of Indirect Costs originally started at the State and regional levels. Discussions at the regional level and at annual AASHTO meetings lead to the first edition of the national audit guide released in December 2001. Over the years many people have contributed to the *Uniform Audit & Accounting Guide* by providing input, conducting research, attending working sessions, facilitating meetings, editing, desktop publishing, proofreading, and other support activities. Representatives from State Highway Agencies, FHWA, ACEC, and AASHTO staff participated. Their knowledge, time, travel money and supplies are greatly appreciated in the nationwide team efforts that lead to the 2005 update.

State Contacts

For questions, comments and input for future updates the audit representative from the local State Highway Agency should be contacted. An updated listing of contacts can be found at:

<http://audit.transportation.org/community/audit/directory.nsf/Map?openform>